Supreme Court, U.S.
FILED
MAR 4 1986
JOSEPH F. SPANIOL, JR.
CLERK

85-1465
No.

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

MARYLAND STATE TEACHERS ASSOCIATION, INC., MARYLAND CLASSIFIED EMPLOYEES ASSOCIATION, INC., and KARL KIRBY PENCE, JR.,
Petitioners,
v.
HARRY HUGHES, GOVERNOR OF THE STATE OF MARYLAND, and BOARD OF TRUSTEES FOR THE MARYLAND STATE RETIREMENT AND PENSION SYSTEMS,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

ROBERT H. CHANIN
(Counsel of Record)
JULIA PENNY CLARK
BREDHOFF & KAISER
1000 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 833-9340

WALTER S. LEVIN
WEINBERG & GREEN
100 South Charles Street
Baltimore, Maryland 21201
(301) 332-8705

J. EDWARD DAVIS
MONICA L. NEWMAN
DAVIS & JENKINS
409 Washington Avenue
Towson, Maryland 21204
(301) 494-9000

Attorneys for Petitioners

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether a 1979 statutory contract entered into by the State of Maryland, pursuant to which it guaranteed that certain public employees "shall, as a condition of that person's employment contract, be entitled" to receive "without change" the retirement benefits provided as of December 31, 1979, is void *ab initio* under the reserved-powers doctrine.

2. Whether the State of Maryland impaired the 1979 statutory contract within the meaning of the Contract Clause of the United States Constitution when, in 1984, it enacted a statute that decreased retirement benefits for the aforesaid public employees.

3. Whether, under the standard set forth by this Court in *United States Trust Co. v. New Jersey*, it was constitutionally permissible for the State of Maryland to impair the 1979 statutory contract for purely financial reasons.

LIST OF PARTIES

In addition to the parties listed in the caption, the following were also plaintiffs in the district court and appellants in the court of appeals:

> Maryland State Educational Services Council, Inc.; Maryland Public Employees Council 67 American Federation of State, County and Municipal Employees, AFL-CIO; Maryland State Employees Council 92 American Federation of State, County and Municipal Employees, Local 2250, AFL-CIO; Nika Jean Potts; Gail Sears Riley; Thomas N. Ellis; Henry Simon, III; Alma C. Brown; Hugh M. Johns; William S. Hudson, Jr.; Harry N. Updegraff; Baltimore Teachers Union, Local 340 (American Federation of Teachers, AFL-CIO); Kenneth R. Bourn, Jr.; Joseph T. Dunn, Jr.; Walter S. Finster; Jane Elizabeth Hearn; Michael W. Marshall; Kathleen R. McGehrin; Edith L. Simms; Ellouise Strock; John R. Johnson; William J. Flanigan; Barton Ingraham; Phillips W. Foster; and Umberto Neri.

The following were also defendants in the district court and appellees in the court of appeals:

> Louis L. Goldstein, William S. James, Theodore E. Thornton, Sr. May Town, H. Louis Stettler, III, Malcolm S. Barlow, John S. Perreca, Leonard W. Dayton, David W. Hornbeck, Peter A. Whittaker, Homer O. Elseroad, Wilbert T. Travers, Jr., Richard J. Benik, James A. Jones, and Bennett H. Shaver, all of whom are members of the Board of Trustees for the Maryland State Pension and Retirement Systems; and Lawrence Bach, Retirement Administrator for the Maryland State Pension and Retirement Systems.

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Petitioners,

v.

HARRY HUGHES, GOVERNOR OF THE STATE OF MARYLAND, and BOARD OF TRUSTEES FOR THE MARYLAND STATE RETIREMENT AND PENSION SYSTEMS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Maryland State Teachers Association, Inc., Maryland Classified Employees Association, Inc., and Karl Kirby Pence, Jr., hereby petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in *Maryland State Teachers Association, Inc., et al. v. Hughes, et al.*, No. 84-2213, entered on December 5, 1985.

OPINIONS BELOW

The opinion of the district court is reported at 594 F.Supp. 1353 (D. Md. 1984), and is reprinted in the Appendix to this petition as Appendix D (14a-48a). The

subsequent opinion of the district court denying the motion to amend the judgment is unreported; it is reprinted as Appendix C (10a-13a). The opinion of the court of appeals is also unreported, and is reprinted as Appendix A (1a-6a).

JURISDICTION

The court below entered judgment on December 5, 1985, Appendix F (53a). This Court has jurisdiction to review that judgment under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, Section 10, Clause 1, of the United States Constitution provides:

> No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . .

The Fourteenth Amendment to the United States Constitution provides:

> Nor shall any State deprive any person of life, liberty, or property, without due process of law . . . .

The two Maryland statutes that are involved in this case are Md. Code Ann. Art. 73B, §§ 3(9) and 83(9), as enacted in 1979, which is reprinted as Appendix H (82a), and 1984 Md. Laws ch. 7, which has been codified in Md. Code Ann. Art. 73B and is reprinted as Appendix G (56a).

STATEMENT OF THE CASE

A. Factual Background

Prior to January 1, 1980, Maryland public employees participated in and, upon retirement, received benefits from two state retirement systems (hereinafter "Old Retirement Systems").[1] In 1979, Maryland enacted a

[1] Public school teachers participated in the Maryland State Teacher's Retirement System, and employees of the state (and

statute that established, as of January 1, 1980, two new retirement systems for its public employees (hereinafter "New Retirement Systems").[2] The New Retirement Systems differ significantly from the Old Retirement Systems in that they require a lower rate of employee contributions and provide substantially reduced post-retirement benefits. In particular, the New Retirement Systems place a 3% "cap" on annual cost-of-living adjustments for retirees, as opposed to the unlimited cost-of-living adjustments provided by the Old Retirement Systems.

The 1979 statute made participation in the New Retirement Systems mandatory for all public employees hired after December 31, 1979—the effective date of the statute. Public employees who were hired prior to that date, however, were given an option. They could voluntarily transfer to the New Retirement Systems or could remain in the Old Retirement Systems. Most important for present purposes, the 1979 statute provided that each public employee choosing to remain in the Old Retirement Systems:

> shall, as a condition of that person's employment contract, be entitled to remain a member of the [old] retirement system without change in the benefits provided in the [old] retirement system as of December 31, 1979. Any person receiving benefits under the provisions of this subtitle on December 31, 1979 shall continue to receive the benefits as provided in the [old] retirement system as of December 31, 1979.

Md. Code Ann. Art. 73B, sections 3(9) and 83(9).

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certain counties and municipalities) participated in the Maryland State Employees' Retirement System. The two pre-1980 retirement systems are for purposes of this case identical.

[2] One of the new systems was tied to the Maryland State Teachers' Retirement System and the other was tied to the Maryland State Employees' Retirement System. Again, these two retirement systems are for purposes of this case identical.

In addition to expressly guaranteeing that public employees who were at that time participating in the Old Retirement Systems would, as a matter of contract, be allowed to remain in those Systems "without change in the benefits provided . . . as of December 31, 1979," the 1979 statute also spelled out what some of those benefits were. Thus, it provided that "[t]hese benefits shall include but not be limited to," the use of the same formula to compute post-retirement benefits, full post-retirement cost-of-living adjustments and the same rate of employee contribution. *Id.*[3] (The full text of this section of the 1979 statute is reprinted in Appendix H (82a).

In 1984, Maryland enacted a new statute that repudiated the 1979 statutory guarantee. Under the 1984 statute, the approximately 80,000 public employees who had chosen to remain in the Old Retirement Systems are forced to choose one of four options, each of which substantially reduces at least one of the benefits that the 1979 statute had guaranteed would not be changed. These options are as follows:

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[3] Legislative materials accompanying the 1979 statute confirmed the legislative intent that "[t]hose remaining in the old systems would be guaranteed the benefits in effect as of December 31, 1979." Department of Fiscal Services, Maryland General Assembly, Revised Fiscal note to Senate Bill 394 (March 6, 1970).

The Board of Trustees of the Maryland State Pension and Retirement Systems, which is the state agency responsible for administering all of Maryland's public employee retirement systems, sent a newsletter to all members of the Old Retirement Systems in September 1979 stating:

> The Law also strengthens the members' rights to these [December 31, 1979] benefits. Specific language was added to guarantee that any member of the [Old] Retirement Systems who chooses not to transfer . . . will remain in the present plan without change in benefits as a condition of the employment contract.

Maryland State Retirement Systems, *MSRS MEDIA* September 1979 at 1, cols. 1-2.

1. "The 7% Option," which allows the employee to remain in the Old Retirement Systems with the same benefits, but with a 40% increase in the annual rate of contribution—from 5% to 7% of gross salary;

2. "The 5%/5% Option," which allows the employee to remain in the Old Retirement Systems and continue to contribute only 5% of gross salary, but with the post-retirement cost-of-living adjustment capped at 5% per year, as opposed to the full cost-of-living adjustment that had been provided previously;

3. "The Transfer Option," which allows the employee to completely transfer to the New Retirement Systems, under which the employee is largely relieved of the obligation to make further contributions, but which provides substantially reduced post-retirement benefits; and

4. "The Bifurcated Option," which allows the employee to preserve the benefits guaranteed by the 1979 statutory contract for services rendered prior to July 1, 1984, but which provides only the reduced benefits of the New Retirement Systems for services rendered after that date.[4]

The 1984 statute provides that money saved by the state in the first fiscal year of the statute's operation is to be paid into the Old and New Retirement Systems. In subsequent fiscal years, however, the savings may be used for any budgetary purpose whatsoever.

B. Proceedings Below

Petitioners, together with several other public employee organizations and individual public employees, filed this lawsuit as a class action to enjoin implementation of the 1984 statute. Petitioners alleged, *inter alia*, that the 1984

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[4] The 1984 statute provides that any employee failing to select one of the four options will be given the Bifurcated Option. The full text of the statute, 1984 Md. Laws Ch. 7, is reprinted in Appendix G (56a).

statute impairs the obligation of the 1979 statutory contract in violation of the Contract Clause of the United States Constitution.[5] The state consented to entry of a preliminary injunction staying implementation of the 1984 statute until a final ruling on the merits by the district court. After expedited discovery, the parties filed cross-motions for summary judgment.

On September 17, 1984, the district court certified a class of plaintiffs consisting of the approximately 80,000 public employees who had exercised their right under the 1979 statute to remain in the Old Retirement Systems (52a). On that same date, however, the district court granted defendants' motion for summary judgment (52a), and in an opinion filed on September 25, 1984, explained the basis for its ruling (14a).

The district court assumed that the 1979 statute had created a contract between the state and its public employees (25a), but held that "the purported contract rights of the plaintiff class have not been impaired by the 1984 Act." (31a). The court bottomed this holding primarily on what it characterized as the "glaring fact . . . that the challenged legislation does *not* operate to deny vested or merely earned pension rights retroactively," because the Bifurcated Option of the 1984 statute gives employees the "absolute right to protect" retirement benefits that had already accrued based on service rendered before the statute was enacted (27a-28a). (Emphasis in original.) Even if the Contract Clause does apply to changes in benefits to be earned in the future, the court reasoned, an employee could continue to accrue the same benefits that had been promised in the 1979 statute by choosing the 7% Option. In the court's view,

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[5] Petitioners also alleged a violation of the Due Process Clause of the Fourteenth Amendment, a violation of the Maryland Constitution, and a breach of contract under Maryland common law. *See* 51a. Jurisdiction was conferred on the district court by 28 U.S.C. § 1331.

the 40% increase in the employee's contribution rate for the future is not a substantial impairment of the 1979 statutory contract.

Moreover, the district court concluded that "the legitimate expectations of the plaintiff class did not include an immutable, unalterable pension plan as to *future* benefits," because such a contract would have been "void *ab initio* as a surrender of an essential element of the State's sovereignty." (30a). (Emphasis in original.)

Although holding that the 1984 statute does not impair the 1979 statutory contract, the district court also examined the question whether, if there were such an impairment, it is constitutionally permissible under the "reasonable and necessary" standard set forth by this Court in *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977). The court answered this question in the affirmative, noting that even if the 1984 statute does impair contractual rights, that impairment is "minimal at worst" (43a) and permissible under the Contract Clause because it is "prompted by an important and legitimate public purpose." (38a). To justify this latter conclusion, the court reviewed the circumstances leading up to the enactment of the 1984 statute, including the state's assertion that it was necessary to improve the actuarial condition of the retirement systems and to stabilize the state's costs, and concluded that it would "defer to the judgment of the legislature." (45a).

The court of appeals affirmed "on the basis of the district court's opinion." (3a). Judge Murnaghan concurred specially, expressing disagreement with the district court in several respects. He found first that the 1984 statute impairs the 1979 statutory contract[6] by

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[6] Although, as noted, the district court and the majority of the court of appeals assumed that the 1979 statute gave rise to a

requiring employees to pay 7% of salary to receive exactly the same benefits they had been promised in exchange for 5% of salary. In addition, Judge Murnaghan stated that the impairment "plainly altered the state's existing obligations," and is, therefore, retroactive. Nonetheless, Judge Murnaghan concluded that the impairment is not unconstitutional because, as he understood this Court's recent Contract Clause decisions, the financial justification offered by the state made the impairment "reasonable and necessary" to serve an important public purpose. (4a-5a).

REASONS FOR GRANTING THE WRIT

The circumstances which give rise to this lawsuit are by no means unique. As one commentator has observed, "financially troubled governments have begun increasingly to look to [public employee retirement] systems as a source of fiscal relief." Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 Harv. L. Rev. 992, 993 (1977). The reasons for this are not difficult to understand. Legislatures often choose to "maintain or increase current government services without raising taxes" "[b]y making a promise of future benefits instead of meeting public employee demands for increased salaries." *Id.* at 998 n.42. If those promises are not fully funded when they are made, "[l]ater legislatures must choose between reneging on these commitments to a small number of employees and retirees, or unpopularly raising taxes without a commensurate increase in public services." *Id.*

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contract between the state and the public employees, Judge Murnaghan addressed this point specifically, stating:

> In 1979, the legislature promised that the terms of the pension program available to persons who were state employees as of that date would not change in an adverse manner during the remainder of their careers as state employees. There can be no question that the legislature's promise imposed a binding obligation on the State.

(4a-5a).

Confronted with this choice, many states have, like Maryland, attempted to alter the terms of existing public employee retirement systems. Not surprisingly, a large number of lawsuits have ensued, most alleging a violation of the Contract Clause of the United States Constitution. Some of these lawsuits have been resolved on the basis of threshold issues of state law.[7] Most, however, have been decided under the Contract Clause,[8] and have involved important issues of constitutional law, including specifically the application of *United States Trust Co.* to the rights and obligations created by public employee retirement systems.

In *United States Trust Co.*, this Court established a three-step analytical framework for determining whether a state's repudiation of its own contract is a violation of the Contract Clause. Assuming that the language and circumstances indicate that the state intended to enter into an enforceable contract, the threshold inquiry is whether that contract is void *ab initio* under the "reserved-powers" doctrine, on the ground that the state attempted to surrender "an essential attribute of its sov-

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[7] *E.g., AFSCME Councils 6, 14, 65 and 96 v. Sundquist*, 338 N.W. 2d 560, 566-69 (Minn. 1983) (legislature never made an express or implied promise to refrain from increasing employee contribution rate).

[8] *E.g., Allen v. Board of Administration of Public Employees' Retirement System*, 34 Cal. 3d 114, 665 P.2d 534 (1983); *Olson v. Cory*, 27 Cal. 3d 532, 636 P.2d 532 (1980); *Nash v. Boise City Fire Dept.*, 104 Idaho 803, 663 P.2d 1105 (1983); *Singer v. City of Topeka*, 227 Kan. 356, 607 P.2d 467 (1980); *Opinion of the Justices*, 364 Mass. 847, 303 N.E.2d 320 (1973); *Halpin v. Nebraska State Patrolmen's Retirement System*, 211 Neb. 892, 320 N.W.2d 910 (1982); *Association of Pennsylvania State College and University Faculties v. State System of Higher Education*, 479 A.2d 962 (Pa. 1984); *Catania v. Commonwealth of Pennsylvania*, 450 A.2d 1342 (Pa. 1982); *Miles v. Tennessee Consolidated Retirement System*, 548 S.W.2d 299 (Tenn. 1976); *Wagoner v. Gainer*, 279 S.E.2d 636 (W. Va. 1981); *Marvel v. Danneman*, 490 F.Supp. 170 (D. Del. 1980).

ereignty." 431 U.S. at 21-25. If the contract survives this inquiry, the next question is whether the challenged statute has impaired the state's contractual obligations. *Id.* at 17-21. If the answer to this question is yes, the court then must determine whether the impairment is permissible under the Contract Clause, because it is "reasonable and necessary to serve an important public purpose." *Id.* at 25.[9]

The court below [10] purported to track the *United States Trust Co.* analysis, and dealt with each of the foregoing three questions. As we shall demonstrate, however, the answers that it gave conflict with certain fundamental principles established by this Court, decisions of the highest courts of five states and a decision of the United States Court of Appeals for the 9th Circuit. Certiorari should be granted to resolve these conflicts, and to clarify how *United States Trust Co.* applies when a state attempts to change the rights and obligations created by public employee retirement systems.

1. The Reserved-Powers Doctrine

The lower court concluded that an irrevocable promise by a state not to make any changes in retirement benefits to be earned by public employees for future service is void *ab initio* under federal law, since the state "would have 'surrender[ed] an essential element of [its] sovereignty,' " quoting *United States Trust Co.*, 431 U.S. at 23

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[9] Although this Court began its analysis in *United States Trust Co.* with the impairment question, that question presupposes the existence of an otherwise valid contract and is, therefore, more appropriately addressed after it has been determined that the contract at issue is not void *ab initio*. Accordingly, we have for purposes of this petition reordered the questions and shall discuss them in the sequence indicated in text.

[10] Inasmuch as the court of appeals affirmed "on the basis of the district court's opinion" (3a), references to the decision of the court below are necessarily references to the decision and reasoning of the district court.

(25a). The court below explained this conclusion as follows:

> The contract here at issue does not relate to *a municipal bond authorization, such as was involved in United States Trust Co., supra, where a state is not in truth acting as a sovereignty but is reduced to the level of an ordinary individual seeking to borrow money and contracting to repay it with interest. Id.* [431 U.S.] at 25, n.23. Instead, the contract at issue here is one dealing with the level of compensation to be paid State employees and teachers for their services to the State. Such a contract is not one as to which one legislature can bind subsequent legislatures for work and services to be performed by State employees and teachers *in the future.*

(25a) (First emphasis added.)

The position taken by the court below with regard to this issue is in conflict with the decisions of this Court and the decisions of the highest courts of five states.

This Court did not limit its holding in *United States Trust Co.* to "a municipal bond authorization" or other situations in which the state is "seeking to borrow money and contracting to repay it with interest." To the contrary, the clear import of the reasoning in *United States Trust Co.* is that financial obligations of states are, as a general matter, not void *ab initio.* 431 U.S. at 24-25. Indeed, one of the cases that this Court cited to illustrate a valid contract was *Indiana ex rel. Anderson v. Brand,* 303 U.S. 95 (1938), in which the state was held to have violated the Contract Clause when it abrogated existing contracts of lifetime tenure for public school teachers. This decision, rendered over a dissent based upon the reserved-powers doctrine, establishes that states can enter into binding contracts that fix the terms and conditions of employment of public employees. Even earlier, in *Dartmouth College v. Woodward,* 17 U.S. (4 Wheat.)

518, 694 (1819), Justice Story recognized that contracts between states and their employees fixing compensation for the term of employment are valid and "just as much a contract, within the purview of the constitutional prohibition, as a like contract would be between two private citizens." *See also Hall v. Wisconsin*, 103 U.S. 5 (1880).[11]

On this issue, the decision below also conflicts with decisions of the highest courts of the states of Pennsylvania, Massachusetts, Kansas, California and Washington. Each of these courts held that the state was bound, under the federal Contract Clause, to its contractual agreement setting the level of compensation for public employees. *See, Association of Pennsylvania State College and University Faculties v. State System of Higher Education*, 505 Pa. 369, 479 A.2d 962 (1984); *Opinion of the Justices*, 364 Mass. 847, 303 N.E.2d 320 (1973); *Singer v. City of Topeka*, 227 Kan. 356, 607 P.2d 467 (1980), *Sonoma County Org. of Public Employees v. County of Sonoma*, 23 Cal. 3d 296, 591 P.2d 1 (1979),[12] *Carlstrom v. State of Washington*, 103 Wash. 391, 694 P.2d 1 (1985).[13]

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[11] If all contracts by which a state or local government establishes the compensation for public employees were void *ab initio* under the reserved-powers doctrine, it would mean that the collective bargaining agreements that today cover millions of federal, state and local government employees are unenforceable. Jurisdictions that have voluntarily entered into such agreements with representatives of their employees should not now be told that the power to set compensation for public employees is an essential element of government sovereignty that cannot, as a matter of federal law, be made subject to a binding contract.

[12] *See also Allen v. Board of Admin. of Public Employees' Retirement System*, 34 Cal. 3d 114, 120, 665 P.2d 534, 538 (1983) (contract governing retirement benefits for public employee is binding contract and cannot be altered unilaterally without impairing obligation of contract); *Olson v. Cory*, 27 Cal. 3d 532, 538, 636 P.2d 532, 535-36 (1980) (contract fixing compensation for public employment, including retirement benefits, cannot be altered without impairing obligation of contract).

[13] These cases are discussed in more detail, *infra*.

The petition for certiorari should be granted to resolve this conflict as to the application of the reserved-powers doctrine under the federal Contract Clause.

2. Impairment of the Contract

Two factors led the lower court to conclude that the 1984 statute does not constitute an impairment of the 1979 statutory contract requiring justification under the "reasonable and necessary" standard of *United States Trust Co.* Observing that

> [a] very important prerequisite to the applicability of the Contract Clause at all to an asserted impairment of a contract by state legislative action is that the challenged law operate with retrospective, not prospective effect,

(22a-23a), the court below placed primary reliance on its determination that the 1984 statute does not operate retroactively. This is so, the court stated, because under the Bifurcated Option, public employees can limit the statute's impact to retirement benefits earned after the statute's July 1, 1984, effective date, and prevent it from affecting benefits earned for services rendered prior to that date.

To further support its conclusion that the 1984 statute is not subject to scrutiny under the Contract Clause, the court below pointed out that, even if a state's repudiation of its contractual commitment as to retirement benefits to be earned in the future *does* constitute an impairment, the employees in this case could in any event preserve their future benefits by selecting the 7% Option—*i.e.*, by increasing their annual rate of contribution from 5% to 7% of gross salary. The court characterized the impairment caused by this 40% rate increase "to be minimal at worst" (43a), and not sufficient to trigger Contract Clause analysis.

Even if this aspect of the lower court's holding is viewed in the narrowest possible terms—*i.e.*, as a hold-

ing that the constitutional prohibition against contract impairment does not apply to reductions of less than a certain magnitude in public employee retirement benefits to be earned in the future—it still conflicts with decisions of the highest courts of several states.

The Pennsylvania and Massachusetts Supreme Courts both have held that *precisely* this type of legislation is constitutionally invalid unless it can pass muster under the "reasonable and necessary" standard of *United States Trust Co.* In *Association of Pennsylvania State College and University Faculties v. State System of Higher Education*, *supra*, 479 A.2d at 965-66, the Pennsylvania Supreme Court held that a statute increasing the rate of public employee contribution to a retirement system from 5% to 6.25% of gross salary for benefits to be earned in the future was a substantial—and unconstitutional—impairment of a prior statutory contract guaranteeing that employee contribution rates would not be increased.[14]

Similarly, in *Opinion of the Justices*, *supra*, 364 Mass. at 863-66, 303 N.E.2d at 329-30, the highest court of Massachusetts held that to increase the rate of public employee contribution from 5% to 7% of gross salary, contrary to a prior promise that no such increases would occur, would impair the obligation of contract within the meaning of the federal Contract Clause. According to the Massachusetts Supreme Judicial Court, an in-

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[14] Although the opinion in *Association of Pennsylvania State College and University Faculties* does not expressly refer to the *United States Trust Co.* standard, the Pennsylvania Supreme Court rested its holding on the reasoning of an earlier dissenting opinion in *Catania v. Commonwealth State Employees' Retirement Board*, 450 A.2d 1342 (Pa. 1982). *See* 479 A.2d at 966. The dissenting opinion in *Catania* explicitly relied on *United States Trust Co.* in concluding that a statute changing the formula for future accruals of retirement benefits would be unconstitutional as to persons who were already employed when the change was made. *See* 450 A.2d at 1353-54.

crease of this magnitude "would materially increase members' contributions without any increase of the allowances finally payable to those members or any other adjustments carrying advantages to them," and would be "presumptively invalid" unless the state could justify the need for such an impairment. 364 Mass. at 864, 303 N.E.2d at 329.[15]

See also, Singer v. City of Topeka, 227 Kan. 356, 607 P.2d 467 (1980), in which the highest court of Kansas found a violation of the federal Contract Clause when the state attempted to increase from 3% to 7% of gross salary the rate of contribution of public employees for retirement benefits to be earned in the future.

As we move beyond the specific facts of this case to the broader propositions of law necessarily embodied in the lower court's decision, the range of conflict widens. There is certainly no principled reason to restrict the lower court's decision to retirement benefits, and the decision seems to stand, at the very least, for the proposition that the Contract Clause does not prohibit a state from statutorily repudiating its contractual commitments governing *any* type of public employee compensation to be earned in the future. This proposition extends the conflict beyond Pennsylvania, Massachusetts and Kansas: it is also at odds with the position taken by the highest courts of the states of California and Washington.

The California Supreme Court held that the state violated the federal Contract Clause when, following the adoption of a tax limitation proposal (Proposition 13), the legislature declared void all contracts between local

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[15] Because *Opinion of the Justices* was an advisory opinion rendered by the Massachusetts court at the request of the state legislature, the court deemed it inappropriate to address the question whether sufficient justification existed to save the proposed impairment from its presumptive invalidity. 364 Mass. at 864, 303 N.E.2d at 329.

public agencies and their employees that called for future salary increases in excess of those granted to state employees. *Sonoma County Organization of Public Employees v. County of Sonoma, supra.* The court expressly rejected the argument that the Contract Clause allows states to abrogate executory contracts that specify the compensation to be paid to public employees for future services. 23 Cal. 3d at 312-13, 591 P.2d at 9-10. The Supreme Court of Washington likewise held that the federal Contract Clause prohibited a legislative attempt to withhold future wage increases that had been promised in a valid collective bargaining agreement between a public community college district and the organizational representative of its employees. *Carlstrom v. State of Washington, supra,* 103 Wash. at 392, 694 P.2d at 3.

Moreover, in construing the "retroactivity" requirement to mean that abrogation of an executory contract does not constitute an impairment within the meaning of the Contract Clause, the court below misinterpreted a principle that has been recognized by this Court since *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 136-37 (1809). The principle that the Contract Clause prohibits only retroactive impairments means simply that a contract cannot be impaired by a state law if the contract was "*entered into* . . . after the passage of the act." *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213, 254 (1827) (Opinion of Washington, J.) (emphasis added); *id.* at 303 (opinion of Thompson, J.) (to impair a contract, "[t]he law must have a present effect upon some contract in existence"); *id.* at 368-69 (opinion of Johnson, J.) (the law of a state is "valid as it affects posterior contracts"). *See also Texaco, Inc. v. Short*, 454 U.S. 516, 531 (1982) (a "statute cannot be said to impair a contract that did not exist at the time of its enactment"). Once it is shown that a state statute impairs a preexisting contract, the statute is subject to scrutiny under the Contract Clause even if the impairment only re-

lates to actions to be taken under that contract in the future. For example, in *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983), this Court had before it a state statute prohibiting oil and gas producers from passing a tax increase through to consumers on or after September 1, 1979, *id.* at 179. Because the statute was enacted in July 1979, it operated only prospectively, *see* 1979 Ala. Acts, No. 79-434. This Court nonetheless found that the statute impaired private contracts "entered into before the pass-through prohibition was enacted and [whose] terms extended through the period during which the prohibition was in effect," *id.* at 189, and applied a Contract Clause analysis to determine whether the impairment was constitutional.[16]

In sum, the decision below is in substantial conflict with the decisions of the highest courts of several states and of this Court as to what constitutes an impairment of a state's contractual obligations sufficient to trigger Contract Clause analysis. The petition for certiorari should be granted to resolve this conflict.

3. Reasonable and Necessary to Serve an Important Public Purpose

In *United States Trust Co.*, this Court indicated that not every impairment by a state of its contractual obligations is prohibited by the Contract Clause. Even a substantial impairment may be constitutionally permissible if the challenged statute "is reasonable and necessary to serve an important public purpose." 431 U.S. at 25. The lower court's application of this standard conflicts with the position taken by several state supreme courts and another federal court of appeals in two respects.

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[16] *See also Energy Reserves Group v. Kansas Power & Light Co.*, 459 U.S. 400 (1983) (applying Contract Clause analysis to a state statute that affected the price to be paid for natural gas to be produced and delivered in the future under contracts that were in existence before the statute was enacted).

The first point of conflict is in regard to the degree, if any, of deference that should be accorded to the legislature's determination that the contract impairment is reasonable and necessary. Although *United States Trust Co.* warns that because the state's self-interest is at stake when it impairs its own contracts, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate. . . ," 431 U.S. at 26, this formulation leaves open the question of whether the court may accord some degree of deference short of "complete" deference.

Under the lower court's interpretation of *United States Trust Co.*, it was required simply "to assure itself that the State's self interest is not masking the facts . . ." (44a), but "once the facts are brought to light," the court considered itself free to "defer to the judgment of the legislature." (44a-45a). The court below thus did not exercise any independent judgment in determining whether the Maryland legislature's action was reasonable, or whether measures other than impairing the 1979 statutory contract would have satisfied the state's needs. It merely ascertained that *some* facts existed to support the view that contract impairment was justified, and then deferred to the legislature in its adoption of that view.

This Court's decisions subsequent to *United States Trust Co.* indicate that the court must, at the very least, undertake an independent assessment of the reasonableness and necessity of the challenged action when judging the state's impairment of its own contracts. *E.g.*, *Exxon Corp. v. Eagerton*, *supra*, 462 U.S. at 192 n.13; *Energy Reserves Group v. Kansas Power & Light Co.*, *supra*, 459 U.S. at 413; *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 n.15 (1978). And this is the position that has been taken by the highest courts of the states of Washington and California. In *Carlstrom v. State of Washington*, *supra*, the Supreme Court of

Washington held that *United States Trust Co.* requires the court to "appl[y] its independent judgment" to determine whether the impairment was both reasonable and necessary, 103 Wash. at 396, 694 P.2d at 5, and that it was reversible error for the trial court to defer to the legislature's judgment. *Id.* at 396, 694 P.2d at 5. Similarly, in *Sonoma County Organization of Public Employees, supra*, the California Supreme Court squarely placed on the state the "burden of establishing" the need for impairment of its contracts in the aftermath of Proposition 13. 23 Cal. 3d at 310, 591 P.2d at 8. Because the state failed to carry that burden, the court held that the contract impairment was unconstitutional. *Id.* at 313-14, 591 P.2d at 10.

The second point of conflict in regard to the lower court's application of the "reasonable and necessary" standard of *United States Trust Co.* is whether and to what extent that standard permits a state to justify impairment of its own contractual obligations for financial reasons. This Court held in *United States Trust Co.* that, under the Contract Clause, a state cannot refuse to fulfill its financial commitments simply because it would prefer to spend the money for some other purpose. 431 U.S. at 26, 29. Explaining that a state always can find uses for additional money, especially when that money can be obtained by abrogating existing financial commitments rather than by raising taxes, this Court stated that "[i]f a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." *Id.*

The court below interpreted this aspect of *United States Trust Co.* to permit the Maryland Legislature to impair the 1979 statutory contract in order to solve certain purely financial problems connected with the Old Retirement Systems—specifically, to enhance the actuarial soundness of the Systems and allow for more pre-

dictable fiscal planning. (31a-46a). This interpretation of *United States Trust Co.* is in conflict with a decision of the highest court of the State of Washington and a decision of the United States Court of Appeals for the Ninth Circuit.

The Supreme Court of Washington has interpreted *United States Trust Co.* to mean that "[f]inancial necessity, though superficially compelling, has never been sufficient of itself to permit states to abrogate contracts." *Carlstrom v. State of Washington*, *supra*, 103 Wash. at 396, 694 P.2d at 5. On the basis of that interpretation, the court declared invalid the state's attempt to withhold public employees' salary increases that had been incorporated into collective bargaining agreements.

The United States Court of Appeals for the Ninth Circuit also has held that under *United States Trust Co.*, the Contract Clause does not allow a state to justify impairment of its own contracts on the ground that compliance with those contracts has "become too expensive." *Continental Illinois National Bank & Trust Co. v. State of Washington*, 696 F.2d 692, 702 (9th Cir.), *appeal dismissed*, 460 U.S. 1077 (1983). Applying that principle, the Ninth Circuit held that the State of Washington acted unconstitutionally when it imposed new conditions on contractual commitments to complete construction of three power plants due to "severe cost over-runs and lengthy construction delays." *Id.* at 702.[17]

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[17] *See also Singer v. City of Topeka*, *supra*, 227 Kan. at 367-8, 607 P.2d at 476 (increasing public employee retirement plan contribution rate was an invalid impairment, where purpose was to make local plan "actuarially sound," but there was no evidence that local plan or city would be unable to meet retirement obligations in the future or that change would give the employees any benefits they would not otherwise receive); *Association of Pennsylvania State College & University Faculties*, *supra*, 479 A.2d at 966 (increasing public employee contribution rate to shift more of cost of retirement system from state to employees was constitutionally impermissible where purpose was to enhance financial soundness

The foregoing decisions demonstrate that there is substantial disagreement over the application of the Contract Clause when a state offers financial reasons as the justification for impairment of its own contracts. Certiorari should be granted to clarify the rule announced in *United States Trust Co.*, and resolve the conflict in regard to this important question of constitutional law.

The need for review of the lower court's decision by this Court is buttressed by the overlap between the Contract Clause and the Due Process Clause of the Fourteenth Amendment. This Court established long ago that valid contract rights are a form of property protected by the Due Process Clause. *E.g.*, *West River Bridge Co. v. Dix*, 47 U.S. (6 How.) 507 (1848). *See also Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 104 S.Ct. 2862 (1984); *Armstrong v. United States*, 364 U.S. 40, 44-45 (1960). For that reason, when a state attempts to abrogate its contractual obligations, the standards of the Contract Clause must be carefully tailored and applied so as not to allow the state to extinguish its contractual partners' rights without the just compensation that would be required when any other form of property is taken for a public purpose. *See United States Trust Co., supra*, 431 U.S. at 19 n.16.

In parallel cases involving federal action under the Fifth Amendment, this Court has not allowed an abrogation of government contracts for the purpose of reducing

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of the retirement system); *Miles v. Tennessee Consolidated Retirement System, supra*, 548 S.W.2d at 305 (reducing retirement benefits "to alleviate the funding problems of the pension system" was invalid impairment because it was not needed to protect a vital interest of the state); *Marvel v. Danneman, supra*, 490 F.Supp. at 176-77 (in absence of evidence that state's "finances are in a precarious state," Contract Clause prohibits attempt to increase judges' contribution rate so that "public funds will bear substantially less of the costs of judicial pensions and that the judges will pay a correspondingly greater proportion of that cost").

expenditures. In *Lynch v. United States*, 292 U.S. 571 (1934), this Court held that Congress violated the Fifth Amendment "taking clause" when it repealed its obligations under contracts of war-risk insurance, explaining:

> No doubt there was in March, 1933, great need of economy. In the administration of all government business economy had become urgent because of lessened revenues and the heavy obligations to be issued in the hope of relieving widespread distress. Congress was free to reduce gratuities deemed excessive. *But Congress was without power to reduce expenditures by abrogating contractual obligations of the United States.* To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an act of repudiation.

292 U.S. at 580 (Emphasis added). This decision was relied upon by this Court in *United States Trust Co.* for applying a stricter standard when a state seeks to impair its own as opposed to private contracts, and for the proposition that a state cannot abrogate its contractual obligations in order to spend money on something else. 431 U.S. at 26 n.25.

If the *Lynch* principle, as reflected in *United States Trust Co.*, is not followed strictly, states will be free to appropriate the rights of those who have contracted with a public body whenever a need arises to reduce government spending or to use government funds for other purposes. The lower court held that this is permissible under the Contract Clause. Certiorari should be granted, therefore, not only to resolve the conflicts between the decision below and the other decisions cited in this petition, but also to make clear that there is no inconsistency between the limitations imposed on the states by the Contract Clause and by the Due Process Clause of the Fourteenth Amendment.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

ROBERT H. CHANIN
(Counsel of Record)
JULIA PENNY CLARK
BREDHOFF & KAISER
1000 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 833-9340

WALTER S. LEVIN
WEINBERG & GREEN
100 South Charles Street
Baltimore, Maryland 21201
(301) 332-8705

J. EDWARD DAVIS
MONICA L. NEWMAN
DAVIS & JENKINS
409 Washington Avenue
Towson, Maryland 21204
(301) 494-9000

Attorneys for Petitioners

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 84-2213

MARYLAND STATE TEACHERS ASSOCIATION, INC., a Maryland Corporation; MARYLAND STATE EDUCTIONAL SERVICES COUNCIL, Inc., a Maryland Corporation; MARYLAND CLASSIFIED EMPLOYEES ASSOCIATION, INC.; MARYLAND PUBLIC EMPLOYEES COUNCIL 67 AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, (AFL-CIO); MARYLAND STATE EMPLOYEES COUNCIL 92 AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, (AFL-CIO); AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, LOCAL 2250 (AFL-CIO); NIKA JEAN POTTS; GAIL SEARS RILEY; THOMAS N. ELLIS; HENRY SIMON, III; ALMA C. BROWN; HUGH M. JOHNS; WILLIAM S. HUDSON, JR.; HARRY N. UPDEGRAFF; BALTIMORE TEACHERS UNION, LOCAL 340 (AMERICAN FEDERATION OF TEACHERS, AFL-CIO); KENNETH R. BOURN, JR.; JOSEPH T. DUNN, JR.; WALTER S. FINSTER; JANE ELIZABETH HEARN; MICHAEL W. MARSHALL; KATHLEEN R. MCGEHRIN; KARL KIRBY PENCE, JR.; EDITH L. SIMMS; ELLOUISE STROCK; JOHN R. JOHNSON; WILLIAM J. FLANIGAN; BARTON INGRAHAM; PHILLIPS W. FOSTER; UMBERTO NERI,

Appellants,

versus

HARRY HUGHES, Governor of the State of Maryland; BOARD OF TRUSTEES FOR THE MARYLAND STATE RETIREMENT AND PENSION SYSTEMS; LOUIS L. GOLDSTEIN,

a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, Comptroller of the Treasury; WILLIAM S. JAMES, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, State Treasurer; THEODORE E. THORNTON, SR., a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, Secretary of Personnel; MAY TOWN, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; H. LOUIS STETTLER, III, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, Secretary; MALCOLM S. BARLOW, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; JOHN S. PERRECA, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; LEONARD W. DAYTON, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; DAVID W. HORNBECK, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; PETER A. WHITTAKER, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; HOMER O. ELSEROAD, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; WILBERT T. TRAVERS, JR., a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; RICHARD J. BENIK, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; JAMES A. JONES, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; BENNETT H. SHAVER, Secretary of the Board of Trustees for the Maryland State Pension and Retirement Systems; LAWRENCE BACH, Retirement Administrator for the Maryland State Pension and Retirement Systems,

Appellees.

Appeal from the United States District Court
for the District of Maryland, at Baltimore
James R. Miller, Jr.,
District Judge. (CA M-84-1435)

Argued: October 7, 1985. Decided: December 5, 1985

Before RUSSELL and MURNAGHAN, Circuit Judges, and HAYNSWORTH, Senior Circuit Judge.

PER CURIAM:

In this class action the plaintiffs/appellants, twenty-two individual Maryland public employees and various employee organizations representing them, challenge the constitutionality of Maryland's 1984 Pension Reform Law, 1984 Maryland Laws, Chapter 7, seeking declaratory and injunctive relief against implementation of the 1984 Pension Statute because it impairs a contract between the State and the members of the plaintiff class in violation of the Contract Clause of the United States Constitution, U.S. Const., Art. I, § 10, cl. 1, and also violates the rights of the class members under the due process clauses of the Fifth and Fourteenth Amendments to the United States Constitution under Article 24 of the Maryland Declaration of Rights, and under state contract law. The defendants/appellees are the Governor of Maryland and the members of the board of trustees of Maryland State Pension and Retirement Systems.

The district court in a full and well-reasoned opinion granted summary judgment in favor of the State on the Contract Clause claim and denied the due process claim. We affirm on the basis of the district court's opinion, *Md. State Teachers Ass'n v. Hughes*, 594 F.Supp. 1353 (D.Md. 1984).

Accordingly, the judgment of the district court is

AFFIRMED.

MURNAGHAN, Circuit Judge, concurring:

While I agree with much of what appears in the opinion of the district court, I do not accept its conclusion that the state employees' contract was not altered or impaired. Prior to the 1984 Pension Reform Act, state employees received, if they so elected, an unlimited cost-of-living adjustment to their pension benefits by contributing five percent of their salaries. After the 1984 Act became effective, state employees had to contribute seven percent of their salaries to obtain the same cost-of-living adjustment. Seven percent is greater than five percent, and that difference constitutes a "substantial impairment" of the contract, requiring a "significant and legitimate public purpose" to justify it. *See Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 411 (1983).

Moreover, it seems to me to be clear that the 1984 Maryland Pension Reform Act was, in fact, retroactive. An enactment is retroactive if it alters the terms of a contractual obligation already in existence. It is not retroactive if its effect is limited to contractual obligations to be undertaken in the future. Here, the 1984 Act plainly altered the state's existing obligations. It is true that the 1984 Act permitted retention by state employees of the benefits which had already accrued before the effective date of the 1984 statute. But for a teacher, say, with ten years service, during which pension benefits accrued on the reasonable expectation that, *in futuro*, they would continue to be calculated on the same basis, there has been throughout the whole ten year period a substantial and reasonable life-affecting reliance on that expectation. From 1971 until 1979, Maryland state teachers and other state employees were entitled to an unlimited cost-of-living adjustment to their pension benefits. Md. Ann. Code Art. 73B, §§ 11A, 86A. In 1979, the legislature promised that the terms of the pension

program available to persons who were state employees as of that date would not change in an adverse manner during the remainder of their careers as state employees. There can be no question that the legislature's promise imposed a binding obligation on the state. There was reliance on there being no adverse change in the very real sense that for ten years one's freedom to elect to stay or to go elsewhere, or, indeed, to change one's professional path had been exercised on the assumption that the promise of no adverse change would be honored. Yet, with the change, the value of the prior ten years was inevitably eroded for they were a part of the teacher's entire professional life and not to be looked at it an isolated fashion as pertaining just to the past ten years. Because the 1984 Act impaired the state's 1971 and 1979 promises, it was undeniably retroactive in effect.

Nevertheless, a recognition that the 1984 Pension Reform Act operated retroactively, and substantially altered the contract rights of state employees, would not alter the disposition of the particular case before us. The retroactive substantial alteration involved state employees and, being reasonable and necessary, constitutionally could be made by the State of Maryland. *Allied Structural Steel v. Spannaus*, 438 U.S. 234, 247 (1978); *United States Trust Co. v. New Jersey*, 431 U.S. 1, 25 (1977).

While I personally might decide the other way if the issue were one appearing before us on a clean slate, it is now established by the Supreme Court in *Spannaus* and *United States Trust Co.*, beyond peradventure, that the Contract Clause of the Constitution prohibition against impairment by any state of the obligation of contracts permits even "substantial" impairment of a contract if that impairment is reasonable and necessary.

Here, as a matter of government policy, bearing in mind the obligation of politicians of the present not to throw posterity to the wolves, the legislation was reasonable and necessary to prevent severe imbalance in future state budgets. The appellants do not dispute that the motivation of the State was benign, not malevolent. Hence, I concur.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil Case No. M 84-1435

MARYLAND STATE TEACHERS ASSOCIATION, INC.,
a Maryland Corporation *et al.*,
Plaintiffs

v.

HARRY HUGHES, Governor of the State of
Maryland, *et al.*,
Defendants

ORDER

The Court having read and considered Plaintiffs' Application for a Stay Pending Appeal, filed on October 26, 1984;

And the Court having read and considered the Defendants' Opposition to the Application for a Stay Pending Appeal, in which the following was represented with respect to the Defendants' restoring the pre-implementation *status quo* should Chapter 7 of the Laws of 1984 ("the Act") be held invalid:

> (1) that the Defendants would promptly refund (without interest) the additional contributions made by those persons who choose the 2% option;
>
> (2) that the Defendants would return those persons who choose the two-part plan (the "bi-furcated" option) to the retirement system and collect payment in an appropriate manner (without interest) of the contributions that would have been due;

(3) that the Defendants would allow persons who transfer to the pension system on or after November 1, 1984 to return to the retirement system upon prompt repayment (without post-transfer interest) of the contributions and interest that were paid to them upon transfer, and appropriate payment (without interest) of the contributions that would have been due;

(4) that the Defendants would not recoup the additional interest payable under the 1984 law over and above the interest payable under prior law from post-November 1, 1984 transferees who choose to remain in the pension system; and

(5) that the representation of the Defendants to restore the pre-implementation *status quo* should the Act be held invalid will include all members who retire, died, became disabled or otherwise left active employment prior to the effective date of such restoration, for whom appropriate adjustments in accordance with said representation will be made.

(6) that the Defendants promptly would advise members of the retirement system by letter of the pendency of the appeal in this case and the steps the Defendants would take to restore the pre-implementation *status quo* should the Act be held invalid.

And the Court having heard arguments of counsel for the respective parties on November 6, 1984, at which time counsel for the Defendants reiterated the above representation to restore the pre-implementation *status quo* should the Act be held invalid, and agreed further that the Defendants would include in the aforementioned letter to members of the retirement system language indicating that the Plaintiffs' Application for a Stay Pending Appeal was denied after said representation was made;

And the Court, having determined that said representation constitutes a waiver of the Defendants' 11th Amend-

ment immunity (*see Moreno v. Toll*, 480 F. Supp. 1116 (D. Md. 1979), *aff'd*, 645 F.2d 217 (4th Cir. 1981), *aff'd*, 458 U.S. 1 (1982)), finds that the Plaintiffs will not suffer irreparable harm if a stay pending appeal is denied;

IT IS this 8th day of November, 1984, by the United States District Court for the District of Maryland,

ORDERED that the Plaintiffs' Application for a Stay Pending Appeal, filed October 26, 1984, hereby is DENIED.

/s/ James R. Miller, Jr.
JAMES R. MILLER, JR.
United States District Judge

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil Action No. M-84-1435

MARYLAND STATE TEACHERS ASSOCIATION, INC., *et al.*

v.

HARRY HUGHES, Governor of the State of Maryland, *et al.*

MEMORANDUM AND ORDER

The plaintiffs have moved for an amendment to the judgment entered in this case on September 18, 1984, and an amendment to the findings on which the judgment was based (Paper No. 55).

The plaintiffs point to the August 8, 1984 affidavit of Eugene Kalwarski which asserts that in the "worst case scenario" the loss of benefits under the 7% option was only 1.11%. The plaintiffs argue that the Kalwarski affidavit provided the "central fact upon which the Court's judgment rests [that] the impairment was minimal." Such is not the case.

In the pages preceding the mention of the Kalwarski affidavit, this court established that the 1984 Act did not operate retrospectively and that as a result there was no impairment of contract (slip op. at 19-22). The Kalwarski affidavit was cited to indicate that *even if* prospective impairment were an issue under the Contract Clause, the prospective impairment was minimal.

Assuming that plaintiffs' actuary, Claude Poulin, is correct in his latest affidavit in asserting that the Kalwarksi affidavit contains a gross mathematical error, and assuming that prospective impairment is an issue under the Contract Clause, this court cannot conclude that the prospective impairment was substantial—even if the "ratio of accumulated excess employee contributions to present value of retirement benefits (both at age 60) . . . [is] 11.5%, *not* the 1.11% computed by Mr. Kalwarksi" (Paper No. 55, Poulin Affidavit, ¶ 13).

Second, the plaintiffs ask the court to amend its findings to include a ruling on the plaintiffs' motion to strike "so that Plaintiffs may know what evidence underlies the District Court's decision and what constitutes the record on appeal."

In general, the admissibility of evidence on a motion for summary judgment is subject to the general rules relating to form and admissibility at trial. *See, e.g., Munoz v. International Alliance of Theatrical Stage Employees*, 563 F.2d 205, 207 n.1 (5th Cir. 1977); *Roucher v. Traders & General Insurance Co.*, 235 F.2d 423, 424 (5th Cir. 1956); *608 Hamilton Street Corp. v. Columbia Pictures*, 244 F. Supp. 193, 195 (E.D. Pa. 1965). Just as a judge sitting in a non-jury case may *hear* both admissible and inadmissible evidence and decide the issues solely on evidence that is competent and probative, *see, e.g., Alioto v. Cowles Communications, Inc.*, 623 F.2d 616, 620 (9th Cir. 1980), *cert. denied*, 449 U.S. 1102 (1981); *Multi-Medical Convalescent and Nursing Center v. N.L.R.B.*, 550 F.2d 974, 977 (4th Cir. 1977), *cert. denied*, 434 U.S. 835 (1978), a judge on summary judgment may *receive* both admissible and inadmissible evidence as long as his decision rests on admissible evidence. *See, e.g., Samuels v. Doctors Hospital, Inc.*, 588 F.2d 485, 486 n.2 (5th Cir. 1979), *Cinocca v. Baxter Laboratories*, 400 F. Supp. 527, 529-30 (E.D. Okla. 1975); C. Wright, A. Miller, M. Kane, 10A *Federal Practice and Procedure* § 2722 *passim* (1983).

The plaintiffs moved to strike numerous documents, but this court considered only those documents which, in its opinion, were admissible at trial. Therefore, the plaintiffs' motion to strike is denied summarily.

As to the plaintiffs' assertion that a resolution of the motion to strike is necessary to clarify "what is and is not in the record below," this court refers each party to the opinion filed in this action on September 25, 1984. The most significant evidence relied on by this court has been cited to the court file. Those citations indicate the most significant evidence considered in deciding this case.

This court notes that it did not consider, in rendering its decision, any affidavit from any legislator or staff person. It did not consider any person's view of the motive or intent of the legislature in passing the 1984 Act or any other pension act.

This court did consider the well-documented legislative history attached to those affidavits in the form of committee reports to the legislature. That information is public information, and it was, in the opinion of this court, relevant to the "reasonable and necessary" inquiry.

Further, this court did not consider any documents related to any union's opposition to any of the pension acts, the lobbying efforts undertaken, or whether there was a causal connection between those efforts and transfers from the retirement system to the pension system.

As to the letter of Advice to Melvin Steinberg from Robert Zarnoch which this court alluded to in its opinion, slip op. at 23, it is clear that reference to that letter was merely as an example that in 1979 there was notice given to participants of the retirement/pension systems that their benefits could be modified. *City of Frederick v. Quinn*, 35 Md. App. 626 (1977), had established that principle. Reference to Mr. Zarnoch's letter, if necessary, could be stricken from the opinion without changing the proposition that "anyone interested [should have been]

aware that Maryland law would not extend unalterable contractual protection against change in pension benefits which were to be earned on a pro rata basis by employment service in the future." Slip op. at 23.

Finally, this court did not consider letters from or to Harry Hughes regarding the pension system, news conferences on the subject, newspaper reports, or testimony before committees.

Suffice it to say that the evidence considered was relevant and admissible evidence upon which a decision on summary judgment was appropriate

Accordingly, it is this 4th day of October, 1984, by the United States District Court for the District of Maryland, ORDERED:

1. That the plaintiffs' motion to amend be, and it is hereby, DENIED.

2. That the plaintiffs' motion to strike be, and it is hereby, DENIED.

3. That the Clerk mail a copy of this Memorandum and Order to counsel for the parties.

/s/ James R. Miller, Jr.
JAMES R. MILLER, JR.
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil Action No. M-84-1435

MARYLAND STATE TEACHERS ASSOCIATION, INC., *et al.*

v.

HARRY HUGHES, Governor of the State of Maryland, *et al.*

FILED: September 25, 1984

MILLER, District Judge.

OPINION

On September 17, 1984, this court granted summary judgment to the defendants as to the claims made in this suit on behalf of the plaintiff class that the 1984 "Pension Reform Law" violates the Contract Clause of the United States Constitution and the Due Process Clause of the Fourteenth Amendment. The plaintiff class consists of those public school teachers and state employees who were, on December 31, 1979 and remain, members of the Employees' Retirement System or the Teachers' Retirement System. This opinion is intended to set out briefly the rationale of the court's action.

I. *Factual Background*

Until December 31, 1979, all Maryland teachers and state employees were required to become and remain members of, and contribute to, the Teachers' Retirement System or the Employees' Retirement System. Under

those retirement systems, teachers and employees received defined retirement benefits and a full post-retirement cost of living adjustment (COLA), and, in return, they were required to make annual mandatory contributions of 5% of their respective salaries to the Retirement Systems.

In 1979, the Maryland General Assembly passed Senate Bill 394 and House Bill 634, codified at *Md. Code Ann.*, Art. 73B (1983), which established a two-tiered retirement/pension system for state employees and teachers in Maryland. Under the terms of the statute, a state employee or a teacher could choose to remain respectively in the Employees' Retirement System, *see Md. Code Ann.*, Art. 73B, § 3(9), or the Teachers' Retirement System, *see Md. Code Ann.*, Art. 73B, § 83(9), or could elect to transfer respectively to the Employees' Pension System or the Teachers' Pension System, *see Md. Code Ann.*, Art. 73B, §§ 31-32.

If transfer to the pension system were chosen, the cost of living adjustment on retirement benefits would be capped at 3%, *see Md. Code Ann.*, Art. 73B, § 120 and § 146, but no salary contributions would be required except as to salary in excess of the Social Security Wage Base. In addition, a transferring teacher or employee would receive a refund of a "part of his accumulated contributions [to the Retirement System] as of the date of transfer." *Md. Code Ann.*, Art. 73B, § 14(g) and § 89(1)(e).

The statute provided that those employees or teachers who chose to remain in their respective retirement systems established under Article 73B and who did not elect at any time to transfer to their respective pension systems,

> "shall, *as a condition of that person's employment contract*, be entitled to remain a member of the retirement system without change in the benefits pro-

vided in the retirement system as of December 31, 1979. Any person receiving benefits under the provisions of this subtitle on December 31, 1979 *shall continue to receive the benefits* as provided in the retirement system as of December 31, 1979. These benefits shall include but not be limited to:

(a) The eligibility for service retirement upon completion of 30 years service or attainment of age 60;

(b) The eligibility for a reduced service retirement upon completion of a certain length of service;

(c) The service retirement allowance of one fifty-fifth of average final compensation;

(d) The retirement allowances provided for ordinary or accidental disability;

(e) The selection of options for service or disability allowances;

(f) *The adjustment of the retirement allowance for increases in the Consumer Price Index;*

(g) The death benefit;

(h) *The level of contributions from members;* and

(i) The length of service for members to vest benefits in the system."

(Emphasis supplied), *Md. Code Ann.*, Art. 73B, § 3(9) and § 83(9).

Thus, those teachers and employees who chose to remain in the retirement systems would continue to contribute 5% of their salaries to the systems and would receive, at retirement, full cost of living adjustments.

In 1984, the Maryland legislature passed House Bill 991, the so-called "Pension Reform Law," which amended

Article 73B, effective June 1, 1984. *See* Paper 35, Ex. A. Under the 1984 Act, four retirement benefit options, often referred to as the "menu plan," were substituted as the choices available as of July 1, 1984 to members of the plaintiff class.

The first, *the transfer option*, allows for the transfer as of July 1, 1984, of all service credits from the retirement system to the pension system combined with a return to the employee of part of the employee's contribution to the retirement system. *See* H.B. 991, § 11B(5)(B) and § 86B(6)(B).

The bifurcated option allows an employee or teacher to keep his service credits accumulated before July 1, 1984 in the retirement system at benefit levels available as of December 31, 1979, subject to full cost of living adjustments. For service credited after July 1, 1984, benefits would accrue under the pension system formula subject to a 3% cost of living cap. No employee contributions would be required after July 1, 1984 unless the employee/teacher earned in excess of the Social Security maximum. *See* H.B. 911, §§ 3(9)(C), 11B, and §§ 83(9)(B), 86B.

Under *the 5%/5% option*, past and future service credits would remain in the retirement system but cost of living adjustments would be limited to 5% as to all service, past and future, and employee contributions would continue at 5% of total salary. *See* H.B. 991, § 11C and § 86C.

Finally, if an employee/teacher chose *the 7% option*, past and future service credits would remain in the retirement system with full cost of living adjustments, but effective July 1, 1984, employee contributions to the system would increase from 5% of salary to 7% of salary. *See* H.B. 991, § 11D and § 86D.

The nub of the plaintiffs' suit is their allegation that the 1979 Act, created a contract between the State and the employees and teachers governed by the Act and that

the 1984 amendments unjustifiably impaired the contract in a substantial way in violation of Article I, Section 10 of the Federal Constitution, the Contract Clause.

Jurisdiction exists in this court under 28 U.S.C. § 1331(a).

II. *Contract Clause*

A. *Legal Framework Applicable*

In an apparent shift of emphasis,[1] the Supreme Court recently has revitalized Contract Clause[2] jurisprudence in striking down state legislative action in two cases, *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977), and *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978).

The first case arose out of earlier legislation by the New York and New Jersey legislatures empowering the Port Authority to take over a financially troubled passenger railroad running between New York City and Newark. To relieve investor concern over this added financial burden, the legislatures passed a statutory covenant to the effect that, so long as certain contemplated bonds of the Authority were outstanding and the consent of the bond holders had not been obtained, the Port Authority could not use any revenues or reserves "which have been or shall be pledged in whole or in part as security for such bonds, for any railroads purposes whatsoever other than permitted purposes hereinafter set forth." 1962 N.J. Laws, c. 8, § 6; 1962 N.Y. Laws, c. 209, § 6, quoted in *United States Trust*, 431 U.S. at

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[1] *See generally* Note, A Process-Oriented Approach to the Contract Clause, 89 Yale L.J. 1623 (1980); Note, Rediscovering The Contract Clause, 97 Harvard L. Rev. 1414 (1984); Schwartz, *Old Wine In Old Bottles? The Renaissance of the Contract Clause* (1979) Supreme Court Rev. 95; Note, Revival of the Contract Clause, 65 Va. L. Rev. 377 (1979).

[2] U.S. Const. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . .").

10. Pursuant to this legislation, the Port Authority took over the operation of the railroad in 1962, raising the capital with which to make the acquisition through the sale of bonds to private investors.

By 1973, the actual deficits incurred by the Port Authority from operating its transit system had exceeded the permitted deficits under the statutory covenant, thereby preventing the Port Authority from issuing any new bonds for any new money-losing passenger railroad facilities. Meanwhile, public pressure for greater participation of the Port Authority in mass transit operations increased as the oil shortage of the early 1970's became critical. In response, the legislatures of both states in 1974 repealed the 1962 covenant. United States Trust Company, the holder of outstanding Port Authority bonds, sued to overturn the repeal on the basis that the legislative action violated the Contract Clause. The New Jersey Supreme Court affirmed the trial court's dismissal of the suit on appeal [3] on the ground that the repeal of the covenant was a reasonable exercise of the police power of the states and therefore not a violation of the Contract Clause.

The second case arose out of a Minnesota law, enacted in 1974, subjecting employers to a pension funding charge if, upon termination of a pension plan or the closure of an office in Minnesota, the employer failed to provide full pensions for all employees who had worked for the company for at least ten years. Until 1974, Minnesota had no pension fund legislation. The statute required the employer under those circumstances to make up the deficiency between the amount in the pension fund and the amount needed to provide pensions for such employees. The pension plan of Allied Structural Steel Company provided, in general, that only those employees who reached the age of sixty five while still employed by it were entitled to a pension. Under the plan, the com-

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[3] 353 A.2d 514, 515 (N.J. 1976).

pany was the sole contributor to the pension trust fund, and each year it made contributions to the fund based on actuarial predictions of eventual payment needs.

Shortly after the statute was enacted, the company closed its Minnesota office, leaving at least nine discharged employees who had worked there for ten years or more without vested rights under the company's pension plan. The state notified the company that, under the newly enacted law, the company owed a pension funding charge of approximately $185,000. The company sued, claiming that the statute unconstitutionally impaired its contractual obligations to its employees under the pension agreement. The three-judge federal trial court upheld the validity of the statute as an appropriate exercise of the State's police power.[4]

In *United States Trust Co.*, 431 U.S. 1 (1977), the Supreme Court set forth the analysis applicable in cases involving alleged Contract Clause violations when a state is a party to the contract. *United States Trust* requires the court to address two preliminary matters prior to inquiring whether the Contract Clause has been violated. *Id.* at 17.

First, the court must ascertain if a contractual obligation was created by a statute. *Id.* at 17. "In general, a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State. In addition, statutes governing the interpretation and enforcement of contracts may be regarded as forming part of the obligation of contracts made under their aegis." *Id.* at 17 n.14. Finally, "[t]he obligations of a contract long have been regarded as including not only the express terms but also the contemporaneous state law pertaining to interpretation and enforcement." *Id.* at 19 n.17.

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[4] 449 F. Supp. 644 (D. Minn. 1977).

Second, the court must determine if the State's actions impaired the obligation of the State's contract. *Id.* at 19-21. In *United States Trust*, the Court addressed impairment briefly finding that the state law did not merely modify or replace the old law with "an arguably comparable security provision," but that the new law was an "outright repeal" which "totally eliminated an important security provision and thus impaired the obligation of the States' contract." *Id.* at 19.

The Court, relying on past precedent, said in *United States Trust* that not every impairment by a State of its own apparent contractual obligations is prohibited by the Contract Clause. *Id.* at 21. The " 'essential attributes of sovereign power,' [quoting *Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398 at 435 (1934)], necessarily reserved by the States to safeguard the welfare of their citizens," *id.*, impose a limit on the operation of the Contract Clause in two ways.

In the case of an apparent contract to which a state is a party, the reserved powers doctrine renders void *ab initio* a state contract which "surrenders an essential attribute of its sovereignty," *id.* at 23, since a " 'legislature cannot bargain away the police power of a State,' " *id.*, quoting *Stone v. Mississippi*, 101 U.S. 814 at 817 (1880).

In the case of contracts between private parties or contracts of a state which do not involve a surrender of what the Court sees as "an essential attribute of its sovereignty," a state in the exercise of its police power may constitutionally impair the contractual obligations and rights of private parties, in the former case, or those imposed by its own contract, in the latter case, if the legislation doing so is reasonable and necessary to serve a legitimate or important public purpose. *Id.* at 21-26; *Spannaus*, 438 U.S. 234, 244. *See also Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 411-12 (1983).

Where a state's own contract is involved, "*complete* deference [by a reviewing court] to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." (Emphasis supplied) *United States Trust Co.*, 431 U.S. at 26. In the case of a legislative impairment by a state of a contract between private parties, however, "courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." *Id.* at 23. The severity of the impairment, which must be "substantial" in any event to involve the Contract Clause, *Spannaus*, 438 U.S. at 244-45; *Energy Reserves Group*, 459 U.S. at 411, "increase[s] the level of scrutiny to which the legislation will be subjected." *Id.*

The legitimate expectations of the contracting parties must be examined to determine whether the impairment complained of is "substantial" as well as to determine its level of severity. *United States Trust Co.*, 431 U.S. at 19-20 n.17; *Spannaus*, 438 U.S. at 245-46; *Energy Reserves Group*, 459 U.S. at 411. While "[t]otal destruction of contractual expectations is not necessary for a finding of substantial impairment," *Energy Reserves Group*, 459 U.S. at 411, citing *United States Trust Co.*, 431 U.S. at 26-27, "state regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment." *Energy Reserves Group*, 459 U.S. at 411.

A factor to be considered in determining the legitimate expectations of the contracting parties and, as a result the extent of the impairment, if any, is whether, at least in cases involving areas formally subject to state regulations, "the industry the complaining party has entered has been regulated in the past." *Id.*

A very important prerequisite to the applicability of the Contract Clause at all to an asserted impairment of a contract by state legislative action is that the challenged

law operate with retrospective, not prospective effect. *Ogden v. Saunders*, 12 Wheat. 213 (1827). *See also Old Wine in Old Bottles: The Renaissance of the Contract Clause*, [1979] Supreme Court Rev. 95, 99. *United States Trust Co., supra*, explicitly restates the existence of statutory retroactivity as a necessary predicate for the applicability of the Contract Clause. *United States Trust Co.*, 431 U.S. at 18 n.15. The opinions in both *United States Trust Co.* and *Spannaus* strongly assert that the challenged legislation involved was retroactive and thus, inferentially, impaired the subject contracts. *United States Trust Co.*, 431 U.S. at 14; *Spannaus*, 438 U.S. at 246, 247, 249. No Supreme Court decision has been found in this court's research which has invalidated a non-retroactive state statute on the basis of the Contract Clause.

If it has been determined that a contract exists which has been substantially impaired by subsequent legislative action, then, as previously explained, the third question a reviewing court must decide is whether the challenged legislation is reasonable and necessary to serve a legitimate or important public purpose. It is at this level of analysis that a more strict review is necessary to be applied to contracts of a state than to solely private contracts since the state's self-interest might cause its legislature to make legislative findings and judgments which are not objective but prejudiced in favor of the state. *United States Trust Co.*, 431 U.S. at 26. Nevertheless, this is not to say that the legislative history and findings are to be ignored or that the court is to sit as a super legislature, making its own totally independent assessment of reasonableness and necessity. As the Court in *United States Trust Co.* said, 431 U.S. at 26, it is only "*complete* deference" (emphasis supplied) to the legislative findings which is to be avoided. And, in both public as well as private contract cases, the level of court scrutiny will vary directly with the extent of the contractual im-

pairment imposed by the challenged legislation. *Energy Reserves Group*, 459 U.S. at 411.

In *El Paso v. Simmons*, 379 U.S. 497, at 508-09 (1965), the most recent Contract Clause decision prior to *United States Trust Co., supra*, and one of those decisions to which the Court in *United States Trust Co.* specifically gave "due respect," 431 U.S., at 16, the Court referred to the judicial respect due to the " 'wide discretion on the part of the legislature in determining what is and what is not necessary,' " quoting *East New York Savings Bank v. Hahn*, 326 U.S. 230, 232-33 (1945). The Court in *El Paso v. Simmons* went on to say, as had Supreme Court decisions before it, e.g., *Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398 (1934), and as did *United States Trust Co.*, 431 U.S. at 22, after it, that a state nevertheless could not " 'adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them,' " 497 U.S. at 509, quoting *Blaisdell*, 290 U.S. at 439. *El Paso v. Simmons*, it should be noted, was a case involving a legislative contract with the State of Texas relating to the sale of state lands.

In short, as this court reads *United States Trust Co., supra*, and the other recent Contract Clause cases, no hard and fast rule exists requiring strict scrutiny of all legislative actions said to constitute a state's impairment of its own contract. But a reviewing court must bear in mind in such a case, when examining legislative statements as to the reasonableness and necessity for such actions, that more strict than usual examination of the facts underlying those statements should be conducted, *United States Trust Co.*, 431 U.S. at 26, and that the state may not justify an impairment of its contractual financial obligations to others simply because it would rather spend the money for some other public purpose, *id.* at 29.

When considering whether a state has shown that its legislative actions, having the effect of substantially im-

pairing its own prior contract, are nevertheless "reasonable and necessary to serve an important public purpose," *id.* at 25, the reviewing court has been given guidance by the Supreme Court in *United States Trust Co.* as to the meaning of the terms "reasonable and necessary" in that context.

Reasonableness is to be judged in the light of whether the prior state contractual obligations or counterpart private rights "had effects that were unforeseen and unintended by the legislature" when the "contract" creating those obligations and rights was created. *Id.* at 31.

Necessity is to be judged on two levels: 1) whether a less drastic modification could have been implemented; and 2) whether, even without modification, the State could have achieved its stated goals. *Id.* at 29-30.

B. *Is There A Contract?*

For the purposes of this decision, it has been assumed, without deciding, that the 1979 Act created a contract between the State and its employees and teachers.

If the contract were irrevocable, it appears to this court that such a contract would be void *ab initio* since it would have "surrender[ed] an essential element of [the State's] sovereignty." *United States Trust Co.*, 431 at 23. The contract here at issue does not relate to a municipal bond authorization, such as was involved in *United States Trust Co., supra,* where a state is not in truth acting as a sovereignty but is reduced to the level of an ordinary individual seeking to borrow money and contracting to repay it with interest. *Id.* at 25 n.23. Instead, the contract at issue here is one dealing with the level of compensation to be paid State employees and teachers for their services to the State. Such a contract is not one as to which one legislature can bind subsequent legislatures for work and services to be performed by State employees and teachers *in the future.*

See, e.g., Newton v. Commissioners, 100 U.S. 548, 559 (1879) (under the police power a state may "increase or diminish the salary or change the mode of compensation"); *Butler v. Pennsylvania*, 10 Howard 402, 416 (1851) (regulation of compensation is part of the "class of powers and obligations by which governments are enabled, and are called upon, to foster and promote the general good; functions, therefore, which governments cannot be presumed to have surrendered. . . ."); *see also Arceneaux v. Treen*, 671 F.2d 128, 135 (5th Cir. 1982); *Local Division 589 v. Commonwealth of Massachusetts*, 666 F.2d 618, 641 (1st Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982).

In fact, the plaintiffs, presumably recognizing the preposterousness of a position that a contract of this type is irrevocable, admit that the contract asserted to exist here may be altered (Paper 47, at 26).

Under Maryland law, the State has reserved the power to amend or alter pension contracts, and that reserved power ". . . is part of each pension plan which a legislature enacts, whether explicitly or not." *Baker v. Baltimore*, 487 F. Supp. 461, 468 (D. Md. 1980), *aff'd*, 660 F.2d 488 (4th Cir. 1981); *see also City of Frederick v. Quinn*, 35 Md. App. 626 (1977).

As Judge Kaufman stated in *Baker v. Baltimore*, *supra*, "what alterations in [the pension system] are permissible is [governed by] the law of the state which . . . took such action or actions." *Id.* at 466.

In *City of Frederick v. Quinn*, *supra*, the court stated that "[e]ach case where a changed plan is substituted must be analyzed on its record to determine whether the change was reasonably intended to preserve the integrity of the pension system by enhancing its actuarial soundness, as a reasonable change promoting the paramount interest of the State without serious detriment to the employee. In short, the employee must have available

substantially the program he bargained for and any diminution thereof must be balanced by other benefits or justified by countervailing equities for the public's welfare." 35 Md. App. at 631.

In essence, *Quinn* calls for the court to determine whether the changes to the pension system tend to enhance the actuarial soundness of the plan. If the answer to that inquiry is affirmative, the court must also assess the detriment to the employees. A diminution in benefits may be found non-serious if the benefits lost are offset by benefits received or if the loss is justified by countervailing public welfare equities. The standard of review of the validity of State legislative action in the exercise of its police power is well established in Maryland. *See Supermarkets Gen. Corp. v. State*, 286 Md. 611, 616-17 (1979); *Edgewood Nursing Home v. Maxwell*, 282 Md. 422, 427 (1978); *Governor v. Exxon Corp.*, 274 Md. 410, 424-25 (1976); *A & H Transp., Inc. v. Baltimore*, 249 Md. 518, 528-29 (1968).

The validity of the 1984 Act as a matter of State law will be analyzed in Part II.D of this Opinion.

C. *Was There An Impairment?*

The glaring fact emerging from the welter of documents and affidavits in the record here is that the challenged legislation does *not* operate to deny vested or merely earned pension rights retroactively.

As to pensions which have already vested and were being paid on the effective date of the legislation, the 1984 Act specifically states that no such pension benefits are intended to be modified or changed. 1984 Md. Laws Chap. 7.[5]

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[5] 1984 Maryland Laws Chapter 7 purported to repeal and reenact with amendments Chapter 23, Laws of 1979, section 3 and Chapter 24, Laws of 1979, by stating: "Except As Modified By Chapter — Of The Acts of 1984 (S.B. —— or H.B. —— 41r1916)" the retire-

As to pensions which, although not vested technically, have been earned as of July 1, 1984, in the sense that an employee has earned pro rata future pension benefits as he or she worked day by day up to July 1, 1984,[6] the provisions of the 1984 Act give the employee an absolute right to protect those earned pension benefits. The bifurcated option of the "menu plan" allows all members of the plaintiff class to keep their full service credits accumulated before July 1, 1984, in the retirement system at benefit levels available as of December 31, 1979, subject to full cost of living adjustments. Only for service rendered after July 1, 1984, are benefits accrued under the pension system formula of .8% of average final compensation, instead of 1.8% as under the retirement system, and subject to a 3% cost of living cap. Under the bifurcated option, no employee contributions are required after July 1, 1984, unless the employee earns thereafter in excess of the Social Security maximum, now

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ment benefits of any beneficiary of the retirement systems are not altered or changed.

According to the Legislative Reference Bureau, "S.B. 647" was to be inserted into those blanks, but S.B. 647 was not passed by the legislature. Therefore, the Act's statement that the benefits of those who are retired are not altered or changed is not modified by an exception.

[6] Pursuant to *Md. Code Ann.*, Art. 73B, § 11(16) and § 86(10), a member of the retirement system who has rendered 5 or more years of creditable service has a vested right to pension benefits upon retirement. Retirement, under usual circumstances, may occur after a member reaches the age of 60 or has rendered the requisite years of creditable service. *Md. Code Ann.*, Art. 73B, § 11(1) and § 81(1). That is not to say that the entitlement to a specific dollar amount of pension benefits vests in the employee, but rather that the right to some benefits vests as they are proratedly earned. As demonstrated in *City of Frederick v. Quinn*, 35 Md. App. 626 (1977), the State has no "right to withdraw retroactively the pro rata pension benefits that [have] accrued," but the State may modify prospectively the amount of benefits. *Id.* at 630-31.

$37,800 as set out in 42 U.S.C. § 430, 48 Fed. Reg. 50414 (Nov. 1, 1983). 1984 Md. Laws Chap. 7, §§ 3(9)(C), 11B, and §§ 83(9)(B), 86B. In short, the members of the plaintiff class have it within their power by choosing the bifurcated option to protect all of the pension benefits which they have earned under the old retirement system by their work up to the effective date of the 1984 Act. In this most important sense, therefore, the 1984 Act, as contrasted with the effect of the invalid statutes involved in *United States Trust Co., supra,* and *Spannaus, supra,* do not retroactively deprive the plaintiff class of benefits or rights for which they had bargained.

In *United States Trust Co.,* the security provided to the bond holders when they purchased their bonds years before was "outright repeal[ed]." 431 U.S. at 19. The affected parties in that case had no way to protect the benefits of their bargain which had accrued when they bought their bonds.

In *Spannaus,* the affected party was required to treat employees' *prior* employment time as if their pension rights had vested and to make retroactive payments to the pension fund to make the fund actuarially sound on that basis. 438 U.S. at 246-47. The affected party there, Allied Structural Steel Co., had no way to protect the benefits of its bargain with its employees that benefits for prior employment time would, in general, vest only if the employees remained employed until age sixty five.

The first affidavit of the plaintiffs' actuary, Mr. Claude Poulin, does not rebut this court's conclusion stated above. His analysis of the bifurcated option relates solely to pension benefits earned pro rata for *future* employment periods and ignores the fact that pension benefits earned pro rata for *past* employment periods will not be adversely affected (Paper 36, Attachment, p.0270, *et seq.*). In fact, Mr. Poulin's second affidavit admits that under the bifurcated option the retirement system benefits for employment *before* July 1, 1984, are *exactly the same*

under the 1984 Act as they were under the 1979 Act (Paper 47, Attachment p.0610). Based on Mr. Poulin's second affidavit, there is absolutely no dispute of fact on this point.

The defendant's actuary, Mr. Eugene Kalwarski, also points out in his third affidavit (Paper 46, Attachment) that, under the 7% option of the "menu plan," there is *no reduction* in benefits to be paid by the Retirement Systems. "*Prospectively*, employees are required to increase their contribution rate from 5% to 7% (a 40% rate increase). Past contributions made by the affected members are not adjusted; for example, a member who has already contributed to the Retirement System at 5% for twenty five years and has five years to go would contribute an additional 12% (rather than 40%) in *total* contributions." Kalwarski third affidavit, Paper 46, Attachment, p.2. Even when considering the effect of *future* employment service and increased employee contributions for that *future* service, Mr. Kalwarski points out, using the methodology and assumptions of Mr. Poulin, the "worst case scenario" of the 7% option results in a *maximum* benefit loss of well under two percent for any current member of the Retirement Systems. *Id.* pp. 3-4.

In addition, the legitimate expectations of the plaintiff class did not include an immutable, unalterable pension plan as to *future* benefits to be earned pro rata by *future* employment service. As earlier noted, not only would such a contract have been void *ab initio* as a surrender of an essential element of the State's sovereignty, but writings from the Office of the Maryland Attorney General and an opinion of the Court of Special Appeals of Maryland roughly contemporaneous with the 1979 Act should have made anyone interested aware that Maryland law would not extend unalterable contractual protection against change in pension benefits which were to be earned on a pro rata basis by employment service in the future. 61 *Opinions of the Attorney General* 746

(1976); *City of Frederick v. Quinn*, 35 Md. App. 626, 630-31 (1977); Letter of Advice to Senator Melvin A. Steinberg, dated February 22, 1979, Paper 35, Attachment 3 to Exh. H.

Without belaboring the point further, this court has concluded on the basis of the undisputed facts in the record that the purported contract rights of the plaintiff class have not been impaired by the 1984 Act.

D. *Is the 1984 Act Reasonable and Necessary To Serve An Important Public Purpose?*

To the extent, if any, the 1984 Act impairs the contractual interests of the plaintiff class, the 1984 Act was prompted by an important and legitimate public purpose.

In 1975, the Maryland legislature asked the question, "Are the Maryland Retirement Systems a financial time bomb?" *See* Paper 35, Pension Study Committee, Report to the 1978 Maryland General Assembly at 4, Ex. G 11. To answer that question, the legislature submitted the Maryland Retirement Systems to two independent studies, the Coopers and Lybrand Study and the Winklevoss Study. *See* Paper 35, Exs. G 3a, G 9a, G 9b. Both studies concluded that Maryland's plan for funding its retirement systems would lead to serious financial consequences, not only by increasing the burden on future Maryland taxpayers, but also by threatening the financial soundness of the retirement systems. *See* Pension Study Committee, Report to the 1978 Maryland General Assembly, at 17-26, Paper 35, Ex. G 11.

Therefore, in 1978, the Pension Study Committee of the Maryland General Assembly recommended to the legislature a pension reform package which it predicted would "result in financially sound State Retirement Systems with the costs of the Systems spread in a more equitable fashion between present and future taxpayers in Maryland." *Id.* at 26.

The center point of the Committee's recommendation was the creation of a two-tiered retirement/pension system and a recommendation for full advance funding of a system for providing retirement benefits. *Id.* at 26-35. No recommendation was made concerning reductions or caps on the cost of living adjustment.

In 1979, the Maryland legislature passed the pension reform legislation which created the two-tiered retirement/pension system allowing transfer from the retirement to the pension system if a member so chose. The 1979 Act also provided for full actuarial funding of both the Retirement and Pension Systems. *See Md. Code Ann.*, Art. 73B, § 14. *See also* Paper 35, Ex. G 15 at 5.

The fiscal note attached to the bill projected annual costs of the legislation to require an additional $32.1 million appropriation in fiscal year 1981 increasing to an additional $35.3 million in 1990, but with annual savings to commence before the year 2000. *See* Fiscal Note, Paper 35, Ex. Y at 9. "A key assumption used in the actuarial analysis [was] that approximately 40 percent of the present membership in the Employees and Teachers Pension [sic] Systems [would] elect to transfer to the new system." *Id.* at 8.

In the first six months after the 1979 Act was passed, approximately 32% of the State employees transferred to the new Pension System, but only 18% of the teachers opted for the new system. *See* Admission #50, Ex. II, Paper 35.

As of June 30, 1982, 55% of the State employees and 32% of the teachers had joined the Pension System. *See* Joint Committee on Pensions 1982 Interim Technical Supplement, at 5, Paper 35, Ex. G 15. Although membership in the Teachers Retirement System declined, "the total payroll of the System, on which the State's contribution is based, remained static, reflecting salary increases

granted by local boards of education." *Id.* It was also reported by the Joint Committee on Pensions that:

> "In 1980 an 'experience investigation' (comparison of actual experience with actuarial assumptions) was conducted for the Teachers Retirement Systems. It revealed that terminations for reasons other than retirement were not as great as assumed, that members of the system were retiring in substantial numbers at early moments, and that retirees were living longer than anticipated. These factors necessitated an increase in the State's contribution of 3.5% of payroll. This increase is being phased in at the rate of 1.14% in each of the fiscal years 1983, 1984, and 1985. In fiscal 1985 all of the State systems will undergo another 'experience investigation.' *The actuary attributes the heavy retirement rate experience whereby teachers in the old system retire as soon as eligible to the unlimited cost-of-living provisions.*"

(Emphasis supplied). *Id.* at 5.

In addition, from 1980 to 1983 several other problems surfaced which further undermined the actuarial assumptions upon which the 1979 Act was based.

First, when the 1979 legislation was considered and enacted, it was assumed that municipal corporations would bear approximately the same cost increases as the State in the advance funding formula. *See* Joint Committee on Pensions, 1981 Interim Report at 11, Paper 35, Ex. KK. Due to different demographic characteristics of the workforce of participating municipal corporations and a drafting error in the 1979 legislation regarding the method used to pay off accrued liabilities of the system, pension costs to municipal corporations increased significantly. *Id.* at 12. After the 1980 funding valuation by state actuaries, "[t]he flat annual payments of the 'municipal corporations' increased from roughly $4 million annually to somewhat more than $12 million."

See 1984 Report of the Joint Legislative & Executive Committee on Pensions, at 22, Paper 35, Ex. NN. Because the financial hardship on the municipal corporations was severe, a three-year moratorium was imposed on municipal corporations' payments to the system. *Id.*

Second, in June 1981, the State's actuary reported that its computation of the allowance for the cost of living adjustments in the 1979 projection of costs of the pension reform legislation was done on a simple rather than a compounded basis as was required by law. *See* Paper 35, Ex. G 15, at 6 & 21. "When this was corrected the State's unfunded accrued liability and contributions substantially increased." *Id.* at 6.[7]

Third, a drastic increase in inflation from 1979 to 1983 occurred aggravating the already existing COLA problem. In 1979, state actuaries assumed a 5% cost of living adjustment per year, but the inflation rate far exceeded that assumption. Stettler Affidavit, Table 1, Consumer Price Index, Paper 35, Ex. JJ. The cost of living increase to state retirees in fiscal year 1981 was 11.3%; in fiscal year 1982, 13.5%; and in 1983, 10.4%. *See* Report of the Joint Legislative & Executive Committee on Pensions, at 27 (January, 1984), Paper 35, Ex. NN.

In January, 1983, when the Joint Pension Committee reported to the legislature on the financial condition of the State Retirement and Pension Systems, it stated:

> "It is evident that the overall situation is not improving yet. Exhibit D shows the State's unfunded

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[7] This error apparently has long term effects on the State's budget. The $30.1 million actuarial error apparently increased the unfunded accrued liability of the system by $578 million in a single year. "The miscalculation will require extra millions in additional funding each year for approximately 38 more years—estimated at $1.2 billion." *See* Stettler affidavit ¶ 17, Paper 35, Ex. JJ.

> accrued liability has increased at a rate far greater than the annual 5% expected when full-funding was adopted in 1979. Much of this increase can be attributed to the COLA. These attributions include; an error in the interpretation of the COLA computation (Exhibit F), adverse actuarial experience (Exhibit G) attributed to the unlimited cost-of-living adjustments in the Teachers Retirement System (Exhibit H), and actuarial losses due to inflation exceeding the assumed 5% annually."

See Joint Committee on Pensions, 1982 Interim Technical Supplement, at 14, Paper 35, Ex. G 15.

The actuarial error and the unpredictable COLA led to the need for an appropriation of $432.2 million for fiscal 1984 to fund the retirement/pension systems.[8] That figure was nearly $103 million higher than the 1983 budget figure,[9] and $46 million higher than had been previously predicted by State actuaries. Stettler Affidavit, ¶ 18, Paper 35, Ex. JJ.

Thus in January, 1983, the Joint Legislative and Executive Committee on Pensions was formed to study the problems inherent in the Retirement/Pension Systems. Executive Order, 01.01.1983.10, Paper 35, Ex. NN at 45. One of the major problems was in the funding of the systems. The Joint Committee's report to the legislature summarized the funding problem as follows:

> "In 1979 when Chapters 23 & 24 were enacted fully funding all of the State's pension obligations it was anticipated that the future contribution rate would be constant at approximately 11.66% of the

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[8] Of the $432.2 million to be appropriated, $362 million would have to come from the State's general fund. *See* Paper 35, Ex. JJ ¶ 18.

[9] Of the $103 million increase, $94 million would have to come from the general fund. *See* Paper 35, Ex. JJ ¶ 18.

applicable payroll. The State's proposed contribution for fiscal 1985 will be 16.93% of the applicable payroll, up from 16.60% in fiscal 1984.

The State's proposed 1985 appropriation of $444.5 million at the 16.93% rate is $138.3 million, or 45%, greater than was anticipated at the 11.66% rate that had been expected to be in effect when Chapters 23 & 24 were enacted in 1979.

In 1975 when the Pension Study Commission began its study to fully actuarially fund the State's retirement obligations the annual retirement costs consumed 5.6% of the annual General Fund appropriations. When the fiscal 1981 budget, the first with full actuarial funding, was adopted during the 1980 session the State's retirement costs took 6.9% of all General Fund appropriations. When the fiscal 1984 budget was adopted at the 1983 session of the General Assembly retirement costs took 10.5% of the General Fund budget. Even with substantially better investment results during the past year the fiscal 1985 budget presented to the legislature by the Governor calls for 10.2% of the General Fund budget to go for retirement costs.

When measured by the accounting standards of the Financial Accounting Standards Board (FASB) utilizing the interest rates promulgated by the Public Benefits Guaranty Corporation (PBGC), standards utilized to measure the status of all private pension plans, the State is having difficulty maintaining its sound actuarially funded position, even with the foregoing substantial budget reallocation of public resources. . . . [Table omitted]

Amongst the six individual retirement and pension systems the State maintains[,] Assest [sic] as a Percent of Vested Benefits varies widely. This reflects the plans with which the State is encountering

difficulties, other than the Judicial Pension Plan which was mature, but had never been actuarially funded prior to 1980. [Table omitted]

The decrease in the vested benefits as a percentage covered by assets in the Employees Retirement System and the Teachers Retirement System improved between fiscal 1982 and 1983. This improvement was due to a very substantial increase in the value of the assets when the S&P Stock Index moved from the 800 level in June of 1982 to the 1200 level in June of 1983, and the approximate interest rate level fell from 14.5% to 11.0% in the same period, thus increasing the value of the MRS&PS trust fund from $2,631.5 million to $3,790.8 million, or by some 44% and $1,159.3 million.

On an actuarial basis the State's unfunded accured [sic] liabilities are continuing to increase, even with the very substantial increase in the value of the assets during fiscal 1983. [Table omitted]

The funding of the State's retirement systems from year to year is quite unstable. Since 1980, when full actuarial funding went into effect, overall General Fund budget appropriations have increased at a rate between 1.5% to 10.9% annually. However, General Fund appropriations for the retirement system contributions have increased at a rate between 4.6% and 34.9% annually. The proportion of the total General Fund increase that has gone to increases in retirement costs has ranged from 6.5% to 49.6% annually. This has created substantial instability in the State's fiscal planning process. . . . [Table omitted]"

Report of the Joint Legislative & Executive Committee on Pensions at 15-16 (January, 1984), Paper 35, Ex. NN.

Based on that report, and the recommendations in it for reform, the legislature amended the 1979 Act intro-

ducing the four retirement system options described previously as the "menu plan."

There can be no rational argument that the 1984 Act was not prompted by an important and legitimate public purpose in the face of this recitation of the undisputed facts.

At the heart of the controversy herein is the unlimited cost of living adjustment (COLA) contained in the 1979 Act. The plaintiffs contend mainly that the cap placed on the COLA by the 1984 Act [10] and the additional 2% of future salary contributions required of members who wish to retain unlimited COLA benefits make up the substantial impairment that the plaintiffs suffer. The defendants, on the other hand, point to the unlimited COLA as one of the main problems in maintaining an actuarially sound plan.

It cannot be questioned that an unlimited COLA is a desirable benefit for retirees from their standpoint. As the plaintiffs state, "[w]ith a full COLA, the plan members are fully protected against the risk of inflation." Paper 36, at 40. That risk is borne by the State, and the retiree's purchasing power remains the same as he/she acquired on the date of retirement. To retain that benefit based on *future* employment service, an employee or teacher, under the 1984 Act, must pay an additional 2% of salary—increased by the 1984 Act from 5% to 7%.

Nor can it be questioned that capping the COLA lends predictability to the retirement system costs and enhances the system's actuarial soundness. *See* Coopers & Lybrand, Study of the Maryland Retirement System, at 4-11 & 4-12 (June 1, 1976), Paper 35, Ex. G 3(a). One need not

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[10] But as has been pointed out in Part II.C of this Opinion, no cap is placed under the bifurcated option on the COLA for benefits based on employment prior to July 1, 1984.

be an actuary [11] to conclude that predictable cost of living increases for future retirees stabilizes cash in-flow and out-flow projections, allows for sounder investment strategies, and provides a more predictable basis for actuarial assumptions. Each of those outcomes tends to increase the actuarial soundness of a pension system.

The plaintiffs argue that the State's retirement/pension systems were sound in 1984 and point to the cover letter to the Milliman and Robertson Study submitted to the Board of Trustees for the Maryland State Retirement and Pension Systems in 1983 as proof that the systems were sound. Eugene Kalwarski, consulting actuary from Milliman and Robertson, stated in that letter: "The most recent actuarial valuation of the systems as of June 30, 1982 indicated that the systems are in sound actuarial condition but that the pattern of budget cost projections is not sufficiently predictable." *See* Documents and Evidence in Support of Plaintiffs' Motion for Summary Judgment, at 201, Paper 36, Attachment.

Accepting the conclusion of actuarial soundness of the systems as true, this court observes that neither *Baker v. Baltimore*, *supra*, nor *City of Frederick v. Quinn*, *supra*, requires as a matter of State law that the legislature wait until a pension system is actuarially unsound before making changes in that system. Certainly, there is no such federal constitutional requirement. Such a requirement would jeopardize the pension benefits of current and future retirees, would require that the trustees of the Retirement Systems abdicate their role as fiduciaries, and would impose an irrational limitation on the legislature's police power. A pension system need not be actuarially unsound before a legislature may move to

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[11] The actuaries on each side of this controversy agree that capping the COLA enhances predictability in the system. *See* Poulin Deposition at 57, Paper 40, Ex. 2; Kalwarski Affidavit, ¶ 10(b), Paper 35, Ex. AAAA.

change the system and the benefits it provides its members.

The record reviewed herein compels the conclusion the Retirement Systems were, in fact, threatened. The 1979 Act, which created the two-tiered retirement/pension system designed to move a percentage of state employees and teachers from their respective full COLA benefits retirement systems to the pension systems with a 3% COLA cap, was predicted to "result in financially sound State Retirement Systems with costs of the Systems spread in a more equitable fashion between present and future taxpayers in Maryland." *See* Pension Study Committee, Report to the 1978 Session of the Maryland General Assembly, at 26, Paper 35, Ex. G 11.

Reports to the legislature in succeeding years indicated that the prediction was erroneous. In 1981, the Joint Committee on Pensions reported the actuarial error in the COLA assumptions used to make actuarial projections for the 1979 Act. Its report stated, "The Joint Committee on Pensions recognizes the budget situation of state and local governments is such that automatic cost-of-living adjustments equivalent to the consumer price index cannot be afforded." *See* Joint Committee on Pensions, 1981 Interim Report at 70, Paper 35, Ex. KK. The Committee recommended further study of the COLA problem. *Id.*

The 1982 Interim Report to the legislature echoed similar problems in the financial condition of the State Retirement and Pension Systems and placed much of the blame on the unlimited COLA. *See* Joint Committee on Pensions, 1982 Interim Technical Supplement at 14, Paper 35, Ex. G 15.

Finally, in 1984, the Joint Legislative & Executive Committee reported that the State was "having difficulty maintaining its sound actuarially funded position. . . ." *See* Report of the Joint Legislative & Executive Committee on Pensions at 15 (January, 1984), Paper 35, Ex. NN. It

recommended the four option menu plan as a possible solution to the problem.

It is the conclusion of this court that the legislature responded to the problem it perceived as threatening to the system and it moved to enhance the actuarial soundness of the pension systems when it passed the 1984 amendment offering the four option menu plan. That piece of legislation directly addressed the problems perceived to be caused by the unlimited COLA.

In short, after years of studying the problem, the legislature addressed the problem in 1979, confidently predicting that the 1979 legislation would result in a financially sound retirement system where cost could be spread more equitably between present and future taxpayers. Pension Study Committee, Report to the 1978 Maryland General Assembly at p.26, Paper 35, Ex. G 11.

By 1984, that confident prediction had not been borne out, and the Joint Legislative & Executive Committee reported to the legislature that the instability in funding the State's retirement system "has created substantial instability in the State's fiscal planning process . . . ." Report of the Joint Legislative & Executive Committee on Pensions at 16 (January, 1984), Paper 35, Ex. NN.

The plaintiffs consistently argue that the State is not in a financial crises and that its bond rating is AAA. But, as the defendants point out, the financial soundness of a state's pension system is directly related to the bond rating.

Standard & Poor's, which has given Maryland a AAA bond rating, finds state pension fund requirements "particularly notable" in their credit rating analysis. *See* Standard & Poor's Credit Overview at 11, Paper 35, Ex. X3. That rating agency conducts analyses "to determine the suitability of the cost method being used to fund the pension system, and the adequacy of the assumptions employed." *Id.* In February, 1984, Standard & Poor's ex-

pressed serious concern regarding Maryland's financial position. It indicated that the State's "financial position, measured by fund balance and free general fund cash, is low . . ." and while it agreed "that the State's economy, cash flow and financial operations are stable, and may reduce the need to carry large balances, we feel that issuers rated AAA should retain a cushion in their financial position as an added degree of strength. The cushion in Maryland's case is disappointly [sic] low, and virtually non-existent." *See* Letter from Managing Vice President, Standard & Poor's, to Louis Goldstein, February 7, 1984, Paper 35, Ex. X5.

The financial position of the State's pension system clearly affects that "cushion." Maryland funds its pension debt for the most part from the general fund, *see* nn 8 & 9, *supra.*

In February, 1984, Oppenheimer & Co., Inc., a brokerage house, gave Maryland an A+ rating stating, "Total debt (including G.O. [General Obligation] debt of $752 per capita, an unfunded pension liability of $1,272 plus M.O. [Moral Obligation] debt) of $2,201 per capita or 8.7% Actual Value singularly precludes an AAA equivalent rating." *See* Municipal Credit Analysis, Oppenheimer & Co., Inc. at 1 (February 1, 1984), Paper 35, Ex. X4. The brokerage house also noted, "Again, as in prior years, the total debt increased significantly due to an increase in unfunded pension liability from $1,175 per capita to $1,272." *Id.* at 2. While noting that increases in total debt related to unfunded pension liability, it commented that the General Obligation debt had remained "relatively unchanged" and that the Moral Obligation debt had remained "stable" over the years. *Id.*

Although it is impossible to conclude with certainty that the 1984 Act will solve the financial problems identified as serious, the Act clearly enhances the State's ability to plan fiscal strategies more accurately by placing some cap on pension costs.

The 1984 Act was a reasonable response to an important public concern. It addressed the perceived cause of the problem, the unlimited COLA, and did so with little or no impairment to State employees or teachers. "The extent of impairment is certainly a relevant factor in determining reasonableness." *United States Trust Co.*, 431 U.S. at 27. This court has found the impairment to be minimal at worst.

Also relevant to the reasonableness inquiry is whether the 1979 Act "had effects that were unforeseen and unintended." *Id.* at 31. Unpredicted high levels of inflation increasing the cost of living adjustment yearly, fewer transfers from the retirement system to the pension system than anticipated, and actuarial error in computing the cost of living adjustments led to financial problems within the retirement/pension systems which impacted on the State's fiscal planning abilities. The intended effect of the 1979 Act was to stabilize financially the retirement/pension systems. Unforeseen factors eroded that intended effect. Thus changed circumstances "caused the [contract] to have a substantially different impact in [1984] than when it was adopted in [1979]." *Id.* at 32.

Under the circumstances described herein the modifications under the 1984 Act were reasonable, particularly in light of the fact that the impairment, if any, was minimal.

Not only were the modifications reasonable, they were necessary modifications. *United States Trust Co.* instructs the court to consider the nature of the modification. "[A] State is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well." *Id.* at 31. In addition, a court is to examine whether "without modifying the covenant at all, the State could have adopted alternative means of achieving [its] . . . goals. . . ." *Id.* at 30.

Initially, the court reiterates that the impairment, if any, was not a drastic one. Unlike the impairment in

United States Trust Co., characterized as a "total repeal of the covenant," *id.* at 29-30, the impairment if one exists at all, is minimal.

United States Trust Co. explains that "[t]he Contract Clause is not an absolute bar to subsequent modification of a State's own financial obligations" if the modification is reasonable and necessary. 431 U.S. at 25. When a *financial obligation* [12] is modified, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." *Id.* at 25-26. In *United States Trust Co.*, the contract at issue, a municipal bond contract, was found to be "purely financial." *Id.* at 25. Such is not the case at bar.

In the areas of pension reform, unlike the area of municipal bonds, the issues are multifaceted. Projections as to the effect of a particular piece of legislation, like the 1979 Act, are based on actuarial assumptions which may or may not turn out to be accurate. In fact, at oral argument, the plaintiffs' attorney referred to actuaries as "pension bookies." They provide to the legislature their best prediction, but there can be no guarantee that what they predict for the future will actually occur.

The contract herein concerns, not a clear financial obligation, but a complex retirement/pension system. It addresses components of that system, the cost of living adjustment and the contribution a member must make to the retirement system.

Therefore, while the court must look carefully at the necessity for the modification to assure itself that the State's self interest is not masking the facts, once the

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[12] What type of contract should be characterized as a financial obligation alone may not always be clear, but *United States Trust Co.* intimates that when a state throws off its mantel of sovereignty and contracts like a private individual, the contract is purely financial. 431 U.S. at 25 & n.23.

facts are brought to light the court should not act as a super legislature and attempt to second guess which legislative act would have better solved the perceived problem. The legislature has the responsibility and the discretion to act on the facts and information at its disposal.

This court cannot conclude that an evident and more moderate course was available to the legislature. The plaintiffs suggest that problems related to insufficient transfers from the retirement to the pension systems could have been addressed by a refund to induce more transfers, or they suggest that costs due to factors within local jurisdiction's control (*i.e.*, salary increases) could have been allocated to the local jurisdiction. Paper 36 at 54. It is not *evident* to this court that either suggested alternative is less drastic than the one the legislature chose. Because the impairment was not a drastic impairment and because a more moderate course does not clearly evidence itself, this court will defer to the judgment of the legislature.

Similarly, this court will defer to the legislative judgment that there existed no alternative means of accomplishing the legislature's goal which could have avoided modifying the 1979 Act. Perhaps, H.B. 1664 (Chapter 290) (Paper 35, Ex. B), a bill linked to H.B. 991, might be argued to be an alternative and sufficient means to control the pension system costs.

H.B. 1664 was passed on May 8, 1984, one month after H.B. 991,

> "[f]or the purpose of providing for the funding of the State pension and retirement systems by changing provisions for employer contributions to the State systems and the optional system and by reviewing the costs of funding certain liabilities of the systems; providing for the investment of the assets in the State pension and retirement funds; providing

> for health insurance benefits for retirees. . . ; providing for the extension of or the participation under circumstances in the moratorium on certain payments by local governments for a certain period of time; stating the purpose of this Act; and generally relating to the funds and assets of the State pension and retirement systems."

See 1984 Md. Laws Ch. 290 (Paper 35, Ex. B).

The legislature apparently considered H.B. 1664 as an *additional* way of addressing the financial stability of the retirement/pension systems and not an alternative solution to the problem created by the unlimited COLA. This court cannot outguess the legislature in this area. It does not have resources to do so nor, in the opinion of this court, could it do so without overstepping the proper bounds of its power.

To conclude, for all the reasons stated, the 1984 Act modifying the Pension Reform Act of 1979 does not violate the Contract Clause of the United States Constitution. Similarly, the 1984 Act modifies the 1979 Act in a way that complies with state law as set forth in *City of Frederick v. Quinn*, 35 Md. App. 626 (1977).

III. *Due Process Clause*

For the reasons set forth herein, the 1984 Act does not violate the Due Process Clause of the United States Constitution. "The Due Process Clause of the Fourteenth Amendment generally does not prohibit retrospective civil legislation, unless the consequences are particularly 'harsh and oppressive.'" *United States Trust Co.*, 431 U.S. at 17 n.13.

In *Pension Benefit Guaranty Corp. v. R. A. Gray Co.*, —— U.S. ——, 52 U.S.L.W. 4811 (June 19, 1984), the Supreme Court reiterated the standard used to determine if legislation, in particular retrospective legislation, vio-

lates the Due Process Clause. Noting that "[i]t is now well established that legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality and that the burden is on the one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way," *id.* at 4813, *citing Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976), the Court "further explained that the strong deference accorded legislation in the field of . . . economic policy is no less applicable when the legislation is applied retroactively. Provided that the retroactive application of a statute is supported by legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches. . . ." *Pension Benefit Guaranty Corp.*, 52 U.S.L.W. at 4813.

Whether the 1984 Act at issue here is considered a prospective or retrospective piece of legislation, it appears for the reasons set forth herein that the legislation is justified by a rational legislative purpose. The facts indicate that the legislature was validly concerned about the financial soundness of the Retirement/Pension Systems, the increasing monetary burden it placed and would continue to place on Maryland taxpayers, and the impact of the inherent unpredictability in the Retirement Systems' cost of living increases on the ability of the State to plan in a fiscally sound manner.

The legislature's reaction to those concerns, the "menu plan" set out in the 1984 Act, was a response rationally related to the legislative purposes of financially stabilizing the Retirement Systems, spreading their cost more equitably across present and future Maryland taxpayers and enhancing the ability of the State to plan fiscally.

These legislative purposes have been scrutinized herein and the 1984 Act has been found not in violation of the

Contract Clause. Suffice it to say that "less searching standards [are] imposed on economic legislation by the Due Process Clause" than those imposed on the States by the Contract Clause. *Id.* at 4814. In fact, the Supreme Court has "never held . . . that the principles embodied in the Fifth Amendment Due Process Clause are coextensive with prohibitions existing against state impairments of pre-existing contracts." *Id.*

In short, the 1984 Act amending the 1979 Pension Reform Act does not violate the Contract Clause or the Due Process Clause of the United States Constitution.

/s/ James R. Miller, Jr.
JAMES R. MILLER, JR.
United States District Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND

Civil Action No. M-84-1435

MARYLAND TEACHERS ASSOCIATION, INC., *et al.*

v.

HARRY HUGHES, Governor of the State of Maryland, *et al.*

ORDER

A. *Class Certification*

The plaintiffs seek certification of a class (Paper No. 15). Their motion for class certification is unopposed by the defendants (Paper No. 20).

The proposed class is composed of the approximately 80,000 individual teachers and employees employed by the State of Maryland who are active members of the Teachers' Retirement System of the State of Maryland or the Employees' Retirement System of the State of Maryland, and who have not retired.

The proposed representatives of the putative class are designated to be twenty-two (22) individuals, each of whom is a member of the class; the Maryland State Teachers Association, a professional association which represents professional teacher and school employee class members; the Maryland State Educational Services Council, Inc., a professional organization which represents public school support personnel class members; the Mary-

land Classified Employees Association, a labor organization representing employee class members; AFSCME Council 67, a labor organization affiliated with the AFL-CIO which represents employee class members; and AFSCME Council 92, also a labor organization affiliated with the AFL-CIO, which represents employee class members; AFSCME Local 2250, a labor organization representing employee class members and in particular classified school employees in Prince George's County; and the Baltimore Teachers Union, Local 340, a labor organization representing teachers and para-professionals in Baltimore City. (*See* Paper No. 15, Motion for Class Certification, and Paper No. 21, Addendum to Motion for Class Certification).

Based on the affidavits filed by the plaintiffs with their motion and addendum to the motion, this court concludes that the requirements of Fed. R. Civ. P. 23(a)(1) have been met. The class is so numerous that joinder is impractical; common questions of law or fact exist as to each class member; the claims of the representatives are typical of the claims of the class; and the named plaintiffs will adequately represent the interests of the class.

In addition, the action meets the requirements of Fed. R. Civ. P. 23(b). Specifically, "the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole. . . ." Fed. R. Civ. P. 23(b)(2).

B. *Defendants' Motion to Dismiss*

1. *42 U.S.C. § 1983*

The defendants assert that the plaintiffs' Contract Clause claim cannot be enforced under 42 U.S.C. § 1983. Whether § 1983 encompasses Contract Clause claims need not be decided herein. If the defendants prevail in show-

ing no violation of the Contract Clause or the Due Process Clause, no § 1983 violation will exist. Because this court concludes today that no Contract Clause or Due Process Clause violation has been shown, it follows that § 1983 has not been violated.

2. *Pendent State Claims*

The plaintiffs have alleged that the State's action violates Article 24 of the Maryland Constitution which prohibits the unconstitutional taking of property (Paper No. 1, Count III). Further, plaintiffs allege common law breach of contract (Paper No. 1, Count IV).

The defendants argue that the Eleventh Amendment bars such claims. Clearly, the Eleventh Amendment does not bar suits against state officials for violations of federal law, *Ex Parte Young*, 209 U.S. 123 (1908), but in *Pennhurst State School & Hospital v. Halderman*, 52 U.S.L.W. 4155 (Jan. 24, 1984), the Supreme Court held that "neither pendent jurisdiction nor any other bases of jurisdiction may override the Eleventh Amendment . . ." and concluded that "a claim that state officials violated state law in carrying out their official responsibilities is a claim against the state that is protected by the Eleventh Amendment." *Id.* at 4164.

Therefore, Counts III and IV will be dismissed.

C. *Cross Motions for Summary Judgment*

Both parties have filed motions for summary judgment on the issue of whether the State, in passing H.B. 991, unconstitutionally impaired a contract allegedly made by the legislature in 1979. For reasons to be set forth in an opinion to be filed at a later date, this court concludes that the State's action did not violate the Contract Clause.

The plaintiffs also have alleged the State's action violated the Due Process Clause. For reasons to be ex-

plained in the opinion to follow, such a claim has no merit.

Accordingly, it is this 17th day of September, 1984, by the United States District Court for the District of Maryland, ORDERED:

1. That the plaintiffs' motion for class certification be, and it is hereby, GRANTED.

2. That the defendants' motion to dismiss the plaintiffs' § 1983 claim along with the plaintiffs' pendent state claims be, and it is hereby, GRANTED.

3. That the defendants' motion for summary judgment be, and it is hereby, GRANTED as to both the Contract Clause and the Due Process Clause.

4. That the plaintiffs' motion for summary judgment be, and it is hereby, DENIED.

5. That the Clerk deliver a copy of this Order to counsel for the parties.

/s/ James R. Miller, Jr.
JAMES R. MILLER, JR.
United States District Judge

APPENDIX F

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 84-2213

MARYLAND STATE TEACHERS ASSOCIATION, INC., a Maryland Corporation; MARYLAND STATE EDUCATIONAL SERVICES COUNCIL, INC., a Maryland Corporation; MARYLAND CLASSIFIED EMPLOYEES ASSOCIATION, INC.; MARYLAND PUBLIC EMPLOYEES COUNCIL 67 AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, (AFL-CIO); MARYLAND STATE EMPLOYEES COUNCIL 92 AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, (AFL-CIO); AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, LOCAL 2250 (AFL-CIO); NIKA JEAN POTTS; GAIL SEARS RILEY; THOMAS N. ELLIS; HENRY SIMON, III; ALMA C. BROWN; HUGH M. JOHNS; WILLIAM S. HUDSON, JR.; HARRY N. UPDEGRAFF; BALTIMORE TEACHERS UNION, LOCAL 340 (AMERICAN FEDERATION OF TEACHERS, AFL-CIO); KENNETH R. BOURN, JR.; JOSEPH T. DUNN, JR.; WALTER S. FINSTER; JANE ELIZABETH HEARN; MICHAEL W. MARSHALL; KATHLEEN R. MCGEHRIN; KARL KIRBY PENCE, JR.; EDITH L. SIMMS; ELLOUISE STROCK; JOHN R. JOHNSON; WILLIAM J. FLANIGAN; BARTON INGRAHAM; PHILLIPS W. FOSTER; UMBERTO NERI,

Appellants,

versus

HARRY HUGHES, Governor of the State of Maryland; BOARD OF TRUSTEES FOR THE MARYLAND STATE RETIREMENT AND PENSION SYSTEMS; LOUIS L. GOLDSTEIN,

a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, Comptroller of the Treasury; WILLIAM S. JAMES, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, State Treasurer; THEODORE E. THORNTON, SR., a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, Secretary of Personnel; MAY TOWN, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; H. LOUIS STETTLER, III, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems, Secretary; MALCOLM S. BARLOW, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; JOHN S. PERRECA, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; LEONARD W. DAYTON, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; DAVID W. HORNBECK, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; PETER A. WHITTAKER, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; HOMER O. ELSEROAD, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; WILBERT T. TRAVERS, JR., a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; RICHARD J. BENIK, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; JAMES A. JONES, a member of the Board of Trustees for the Maryland State Pension and Retirement Systems; BENNETT H. SHAVER, Secretary of the Board of Trustees for the Maryland State Pension and Retirement Systems; LAWRENCE BACH, Retirement Administrator for the Maryland State Pension and Retirement Systems,

Appellees.

Appeal from the United States District Court
for the District of Maryland

[Filed Dec. 5, 1985]

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of Maryland, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, Affirmed.

/s/ John M. Greacen
Clerk

APPENDIX G

LAWS OF MARYLAND

CHAPTER 7

(House Bill 991)

AN ACT concerning

Pensions—Benefits and Contributions

FOR the purpose of altering certain conditions of membership in the Employees' and Teachers' Retirement Systems; providing for the computation of retirement allowances, retirement allowance adjustments, and member's contributions from a certain date; providing for the selection of alternative retirement allowances, retirement allowance adjustments, and member's contributions; providing for subsequent selections; *providing for the payment of a certain rate of interest on a member's retirement contributions;* providing for *certain restrictions on the* fiscal year 1985 State general fund appropriations in the State budget for retirement programs; providing for the notification of members by a certain date; making other necessary changes in the pension laws; and relating to benefits and contributions under the Employees' and Teachers' Retirement Systems.

BY repealing and reenacting, with amendments,

Article 73B—Pensions
Section 3(9) and 83(9)
Annotated Code of Maryland
(1983 Replacement Volume)

BY adding to

Article 73B—Pensions
Section 11B, 11C, 11D, 86B, 86C, and 86D
Annotated Code of Maryland
(1983 Replacement Volume)

BY repealing and reenacting, with amendments,

Chapter 23 of the Acts of the General Assembly of 1979
Section 3

BY repealing and reenacting, with amendments,

Chapter 24 of the Acts of the General Assembly of 1979
Section 3

Preamble

In adopting this Act, it is the purpose of the General Assembly to carry out the proposals on pension benefits that were approved by the Joint Legislative and Executive Committee on Pensions and that are described in the Committee's report to the 1984 General Assembly; now, therefore,

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND, That the Laws of Maryland read as follows:

Article 73B—Pensions

3.

The membership of the retirement system shall consist of the following:

(9) (A) EXCEPT AS PROVIDED IN PARAGRAPH (C) OF THIS SUBSECTION, [Any] ANY person who is a member of the retirement system, established by this subtitle, on December 31, 1979 and does not at any time elect to be a member of the Pension System for Employees of the State of Maryland, shall, as a condition of that

person's employment contract, be entitled to remain a member of the retirement system as of December 31, 1979.

(B) Any person receiving benefits under the provisions of this subtitle on December 31, 1979 shall continue to receive the benefits as provided in the retirement system as of December 31, 1979. These benefits shall include but not be limited to:

[(a)] (I) The eligibility for service retirement upon completion of 30 years service or attainment of age 60;

[(b)] (II) The eligibility for a reduced service retirement upon completion of a certain length of service;

[(c)] (III) The service retirement allowance of one fifty-fifth of average final compensation;

[(d)] (IV) The retirement allowances provided for ordinary or accidental disability;

[(e)] (V) The selection of options for service or disability allowances;

[(f)] (VI) The adjustment of the retirement allowance for increases in the Consumer Price Index;

[(g)] (VII) The death benefit;

[(h)] (VIII) The level of contributions from members; and

[(i)] (IX) The length of service for members to vest benefits in the system.

(C) A MEMBER WHO IS SUBJECT TO EITHER OF §§ 11B, 11C, OR 11D OF THIS ARTICLE WHO RECEIVES CREDITABLE SERVICE FROM JULY 1, 1984 IS SUBJECT ONLY TO THE PROVISIONS OF THE APPLICABLE SECTION FOR THE PROPORTION OF EARNABLE COMPENSATION THAT IS PAYABLE, THE COMPUTATION OF THE RETIRE-

MENT ALLOWANCE, AND THE ADJUSTMENT OF THE RETIREMENT ALLOWANCE.

11B.

(1) A MEMBER WHO IS IN SERVICE ON JULY 1, 1984, IS SUBJECT TO THE PROVISIONS OF THIS SECTION. A MEMBER WHO IS NOT IN ACTIVE SERVICE ON JULY 1, 1984 BUT WHO IS ELIGIBLE TO RETURN TO ACTIVE SERVICE IS SUBJECT TO THIS SECTION ON THE DATE OF RETURN TO SERVICE.

(2) FROM JULY 1, 1984, A MEMBER SHALL RECEIVE A RETIREMENT ALLOWANCE AS PROVIDED IN THIS SUBSECTION:

(A) FOR RETIREMENT FOR SERVICE, THE RETIREMENT ALLOWANCE IS COMPUTED:

(I) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 11(3)(A) OF THIS ARTICLE; AND

(II) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 117(2) OF THIS ARTICLE;

(B) FOR EARLY RETIREMENT FOR SERVICE, THE RETIREMENT ALLOWANCE IS COMPUTED:

(I) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 11(3)(A)(I) OF THIS ARTICLE; AND

(II) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 117(4) OF THIS ARTICLE;

(C) FOR RETIREMENT FOR ORDINARY DISABILITY, THE INITIAL RETIREMENT ALLOWANCE IS COMPUTED ON THE GREATER OF:

(I) IF THE MEMBER WAS IN SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 11(5) OF THIS ARTICLE; OR

(II) IF THE MEMBER IS IN SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 117(6) OF THIS ARTICLE; AND

(D) FOR RETIREMENT FOR ACCIDENTAL DISABILITY, THE RETIREMENT ALLOWANCE IS COMPUTED:

(I) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 11(7) OF THIS ARTICLE; AND

(II) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 117(8) OF THIS ARTICLE.

(3) A MEMBER WHO RETIRES FROM JULY 1, 1984 SHALL HAVE THE RETIREMENT ALLOWANCE ADJUSTED:

(A) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 11A OF THIS ARTICLE; AND

(B) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 118 OF THIS ARTICLE.

(4) FOR CREDITABLE SERVICE RECEIVED FROM JULY 1, 1984, THE PROPORTION OF THE EARNABLE COMPENSATION THAT IS PAYABLE BY A MEMBER IS THAT PROVIDED BY § 122(1)(B) OF THIS ARTICLE.

(5) *(A)* A MEMBER WHO IS SUBJECT TO THIS SECTION MAY TRANSFER TO THE PENSION SYSTEM FOR EMPLOYEES OF THE STATE OF MARYLAND, AS PROVIDED BY § 113 OF THIS ARTICLE.

(B) ACCUMULATED CONTRIBUTIONS RETURNED TO THE MEMBER AS OF THE DATE OF TRANSFER PURSUANT TO SECTION 14(1)(G) OR SECTION 89(1)(E) OF THIS ARTICLE SHALL BE RETURNED TO THE MEMBER WITH THE AVERAGE RATE OF INTEREST FOR THE 5 YEARS PRE-

CEDING THE YEAR OF TRANSFER COMPOUNDED ANNUALLY. THE RATE OF INTEREST FOR ANY ONE YEAR SHALL BE COMPUTED AS THE SUM OF THE INVESTMENT INCOME AND THE REALIZED GAINS AND LOSSES DIVIDED BY THE BOOK VALUE OF THE TOTAL INVESTMENTS.

(6) A MEMBER WHO IS SUBJECT TO THIS SECTION WHO AT THE TIME OF RETIREMENT IS ENTITLED TO MEMBERSHIP SERVICE FOR UNUSED SICK LEAVE UNDER § 9(6) OF THIS ARTICLE SHALL HAVE THE TOTAL AMOUNT OF UNUSED SICK LEAVE APPORTIONED IN THE SAME RATIO THAT THE MEMBER'S CREDITABLE SERVICE IS APPORTIONED FOR CALCULATION OF THE RETIREMENT ALLOWANCE UNDER SUBSECTION (2) OF THIS SECTION.

(7) FOR PURPOSES OF COMPUTING A MEMBER'S RETIREMENT ALLOWANCE:

(A) SERVICE CREDIT RECEIVED BY A MEMBER, OTHER THAN SINCE THE INDIVIDUAL LAST BECAME A MEMBER, SHALL BE TREATED AS CREDITABLE SERVICE AS OF THE DATE THE SERVICE WAS RENDERED. THIS PROVISION DOES NOT APPLY TO SERVICE CREDIT RECEIVED PURSUANT TO ARTICLE 65, SECTION 88; AND

(B) BENEFITS FOR MILITARY SERVICE CREDIT, RECEIVED BY A MEMBER PURSUANT TO ARTICLE 65, SECTION 88, SHALL BE DETERMINED AS OF THE DATE THE BOARD OF TRUSTEES VERIFIES THE CREDIT FOR MILITARY SERVICE.

(8) EXCEPT AS PROVIDED IN THIS SECTION, RETIREMENT UNDER THIS SECTION IS SUBJECT TO THE OTHER APPLICABLE PROVISIONS OF THIS ARTICLE.

11C.

(1) NOTWITHSTANDING THE PROVISIONS OF THIS ARTICLE, A MEMBER WHO IS IN SERVICE ON JULY 1, 1984 MAY ELECT TO RECEIVE A RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION.

(2) (A) A MEMBER IN SERVICE ON JULY 1, 1984 WHO WISHES TO SELECT THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL NOTIFY THE EMPLOYEES' RETIREMENT SYSTEM NOT LATER THAN *JANUARY 1, 1985* OF THE ELECTION ON FORMS PROVIDED BY THE SYSTEM. A MEMBER NOT IN SERVICE ON JULY 1, 1984 BUT WHO IS ELIGIBLE TO RETURN TO SERVICE IN THE SYSTEM SHALL HAVE 90 DAYS FROM THE DATE OF RETURN TO SERVICE TO SELECT THE OPTION PROVIDED IN THE SECTION.

(B) THE EXECUTIVE DIRECTOR OF THE STATE RETIREMENT AGENCY MAY ACCEPT AN ELECTION UNDER THIS SUBSECTION FILED BY A MEMBER AFTER *JANUARY 1, 1985* OR AFTER THE EXPIRATION OF 90 DAYS FROM RETURN TO SERVICE UPON RECEIPT OF SATISFACTORY PROOF OF GOOD CAUSE FOR DELAY. FAILURE TO RECEIVE NOTICE OR INABILITY TO RESPOND TO NOTICE SHALL CONSTITUTE GOOD CAUSE.

(3) A MEMBER WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL RECEIVE A RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE AS FOLLOWS:

(A) FOR SERVICE RETIREMENT AS PROVIDED BY § 11(3)(A) OF THIS ARTICLE;

(B) FOR EARLY RETIREMENT FOR SERVICE AS PROVIDED BY § 11(3)(A)(I) OF THIS ARTICLE;

(C) FOR RETIREMENT FOR ORDINARY DISABILITY AS PROVIDED BY § 11(5) OF THIS ARTICLE; AND

(D) FOR RETIREMENT FOR ACCIDENTAL DISABILITY AS PROVIDED BY § 11(7) OF THIS ARTICLE.

(4) A MEMBER WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL HAVE THE RETIREMENT ALLOWANCE ADJUSTED AS FOLLOWS:

(A) FOR ALL FISCAL YEARS BEGINNING THE SECOND JULY 1 FOLLOWING THE DAY PRECEDING THE MEMBER'S DATE OF RETIREMENT, THE RETIREMENT ALLOWANCE PAID DURING THE PRIOR FISCAL YEAR, EXCLUSIVE OF ANY ADDITIONAL VOLUNTARY ANNUITY, SHALL BE ADJUSTED BY THE PERCENTAGE CALCULATED BY THE CONSUMER PRICE INDEX FOR THE CALENDAR YEAR ENDING DECEMBER 31 IN THE PRECEDING FISCAL YEAR DIVIDED BY THE CONSUMER PRICE INDEX FOR THE CALENDAR YEAR ENDING DECEMBER 31 IN THE SECOND PRECEDING FISCAL YEAR;

(B) THE ADJUSTMENT PROVIDED FOR IN PARAGRAPH (A) OF THIS SUBSECTION (4) SHALL NOT EXCEED 5 PERCENT OF THE ANNUAL RATE OF RETIREMENT ALLOWANCE PAID DURING THE PRIOR FISCAL YEAR;

(C) FOR PURPOSES OF THIS SUBSECTION (4), CONSUMER PRICE INDEX SHALL MEAN THE CONSUMER PRICE INDEX, U.S. CITY AVERAGE—ALL URBAN CONSUMERS AS OF DECEMBER 31 AS PUBLISHED BY THE UNITED STATES DEPARTMENT OF LABOR;

(D) THE TOTAL RETIREMENT ALLOWANCE PAYABLE IN EACH FISCAL YEAR SHALL BE THE SUM OF:

(I) THE MEMBER'S ANNUAL RATE OF RETIREMENT ALLOWANCE PAID DURING THE PRIOR FISCAL YEAR;

(II) THE ADJUSTMENT IN RETIREMENT ALLOWANCE PROVIDED FOR UNDER THIS SUBSECTION (4); AND

(III) ANY ADDITIONAL VOLUNTARY ANNUITY; AND

(E) THE ALLOWANCE OF A SURVIVING BENEFICIARY OF A MEMBER OR A RETIRED MEMBER SHALL, WHEN AND IF PAYABLE, BE ADJUSTED IN THE SAME MANNER AS PROVIDED IN THIS SUBSECTION.

(5) FOR CREDITABLE SERVICE FROM JULY 1, 1984, THE PROPORTION OF EARNABLE COMPENSATION PAYABLE BY A MEMBER WHO SELECTS THE OPTION PROVIDED IN THIS SECTION SHALL CONTINUE TO BE THAT PROVIDED BY § 14(I)(A) OF THIS ARTICLE.

(6) A MEMBER WHO SELECTS THE OPTION PROVIDED IN THIS SECTION MAY AFTER SELECTION OF THIS OPTION:

(A) TRANSFER TO THE PENSION SYSTEM FOR EMPLOYEES OF THE STATE OF MARYLAND AS PROVIDED BY § 113 OF THIS ARTICLE;

(B) ACCUMULATED CONTRIBUTIONS RETURNED TO THE MEMBER AS OF THE DATE OF TRANSFER PURSUANT TO SECTION 14(1)(G) OR SECTION 89(1)(E) OF THIS ARTICLE SHALL BE RETURNED TO THE MEMBER WITH THE AVERAGE RATE OF INTEREST FOR THE 5 YEARS PRECEDING THE YEAR OF TRANSFER COMPOUNDED ANNUALLY. THE RATE OF INTEREST FOR ANY ONE YEAR SHALL BE COMPUTED AS THE SUM OF THE INVESTMENT INCOME AND THE REAL-

IZED GAINS AND LOSSES DIVIDED BY THE BOOK VALUE OF THE TOTAL INVESTMENTS; OR

(C) SELECT A RETIREMENT ALLOWANCE AS PROVIDED IN § 11B OF THIS ARTICLE AND THE PROPORTION OF EARNABLE COMPENSATION THAT IS PAYABLE AS PROVIDED IN § 122(1)(B) OF THIS ARTICLE WITH THE EFFECTIVE DATE OF THE SELECTION BEING SUBSTITUTED FOR JULY 1, 1984. THE ADJUSTMENT TO THE RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE PRIOR TO THE DATE OF SELECTION SHALL BE CALCULATED AS PROVIDED IN SUBSECTION (4) OF THIS SECTION AND NOT AS PROVIDED IN § 11A OF THIS ARTICLE. THE ADJUSTMENT TO THE RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE AFTER THE EFFECTIVE DATE SHALL BE CALCULATED AS PROVIDED BY § 118 OF THIS ARTICLE.

(7) EXCEPT AS PROVIDED IN THIS SECTION, RETIREMENT UNDER THIS SECTION IS SUBJECT TO THE OTHER APPLICABLE PROVISIONS OF THIS ARTICLE.

11D.

(1) NOTWITHSTANDING THE PROVISIONS OF THIS SUBTITLE, A MEMBER WHO IS IN SERVICE ON JULY 1, 1984 MAY ELECT TO RECEIVE A RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION.

(2)(A) A MEMBER IN SERVICE ON JULY 1, 1984 WHO WISHES TO SELECT THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL NOTIFY THE EMPLOYEES' RETIREMENT SYSTEM NOT LATER THAN *JANUARY 1, 1985* OF THE ELECTION ON FORMS PROVIDED BY THE SYSTEM. A MEMBER NOT IN SERVICE ON JULY 1, 1984 BUT WHO IS ELIGIBLE TO RETURN TO SERV-

ICE IN THE SYSTEM SHALL HAVE 90 DAYS FROM THE DATE OF RETURN TO SERVICE TO SELECT THE OPTION PROVIDED IN THIS SECTION.

(B) THE EXECUTIVE DIRECTOR OF THE STATE RETIREMENT AGENCY MAY ACCEPT AN ELECTION UNDER THIS SUBSECTION FILED BY A MEMBER AFTER *JANUARY 1, 1985* OR AFTER THE EXPIRATION OF 90 DAYS FROM THE RETURN TO SERVICE UPON RECEIPT OF SATISFACTORY PROOF OF GOOD CAUSE FOR DELAY. FAILURE TO RECEIVE NOTICE OR INABILITY TO RESPOND TO NOTICE SHALL CONSTITUTE GOOD CAUSE.

(3) A MEMBER WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL RECEIVE A RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE AS FOLLOWS:

(A) FOR SERVICE RETIREMENT AS PROVIDED BY § 11(3)(A) OF THIS ARTICLE;

(B) FOR EARLY RETIREMENT FOR SERVICE AS PROVIDED BY § 11(3)(A)(I) OF THIS ARTICLE;

(C) FOR RETIREMENT FOR ORDINARY DISABILITY AS PROVIDED BY § 11(5) OF THIS ARTICLE; AND

(D) FOR RETIREMENT FOR ACCIDENTAL DISABILITY AS PROVIDED BY § 11(7) OF THIS ARTICLE.

(4) A MEMBER WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL HAVE THE RETIREMENT ALLOWANCE ADJUSTED AS PROVIDED IN § 11A OF THIS ARTICLE.

(5) FOR CREDITABLE SERVICE FROM JULY 1, 1984, THE PROPORTION OF EARNABLE COMPENSATION PAYABLE AS PROVIDED BY § 14(1)(A) OF THIS ARTICLE SHALL BE INCREASED BY AN ADDITIONAL 2 PERCENT OF EARNABLE COMPENSATION.

(6) A MEMBER WHO SELECTS THE OPTION PROVIDED IN THIS SECTION MAY AFTER SELECTION OF THIS OPTION:

(A) TRANSFER TO THE PENSION SYSTEM FOR EMPLOYEES OF THE STATE OF MARYLAND AS PROVIDED BY § 113 OF THIS ARTICLE;

(B) ACCUMULATED CONTRIBUTIONS RETURNED TO THE MEMBER AS OF THE DATE OF TRANSFER PURSUANT TO SECTION 14(1)(G) OR SECTION 89(1)(E) OF THIS ARTICLE SHALL BE RETURNED TO THE MEMBER WITH THE AVERAGE RATE OF INTEREST FOR THE 5 YEARS PRECEDING THE YEAR OF TRANSFER COMPOUNDED ANNUALLY. THE RATE OF INTEREST FOR ANY ONE YEAR SHALL BE COMPUTED AS THE SUM OF THE INVESTMENT INCOME AND THE REALIZED GAINS AND LOSSES DIVIDED BY THE BOOK VALUE OF THE TOTAL INVESTMENTS;

(B) *(C)* SELECT A RETIREMENT ALLOWANCE AS PROVIDED IN § 11C OF THIS ARTICLE. THE INCREASE IN THE PROPORTION OF EARNABLE COMPENSATION PAYABLE PROVIDED IN SUBSECTION (5) OF THIS SECTION SHALL NOT BE REFUNDED; OR

(C) *(D)* SELECT A RETIREMENT ALLOWANCE AS PROVIDED IN § 11B OF THIS ARTICLE, THE ADJUSTMENT AS PROVIDED IN *11B(3)* OF THIS ARTICLE, AND THE PROPORTION OF EARNABLE COMPENSATION THAT IS PAYABLE AS PROVIDED

IN § 122(1)(B) OF THIS ARTICLE, WITH THE EFFECTIVE DATE OF THE SELECTION BEING SUBSTITUTED FOR JULY 1, 1984.

(7) EXCEPT AS PROVIDED IN THIS SECTION, RETIREMENT UNDER THIS SECTION IS SUBJECT TO THE OTHER APPLICABLE PROVISIONS OF THIS ARTICLE.

83.

The membership of this retirement system shall be composed as follows:

(9)(A) EXCEPT AS PROVIDED IN PARAGRAPH (B) OF THIS SUBSECTION, [Any] ANY person who is a member of the retirement system, established by this subtitle, on December 31, 1979 and does not at any time elect to be a member of the Pension System for Teachers of the State of Maryland, shall, as a condition of that person's employment contract, be entitled to remain a member of the retirement system without change in the benefits provided in the retirement system as of December 31, 1979. Any person receiving benefits under the provisions of this subtitle on December 31, 1979 shall continue to receive the benefits as provided in the retirement system as of December 31, 1979. These benefits shall include but not be limited to:

[(a)] (I) The eligibility for service retirement upon completion of thirty years service or attainment of age 60;

[(b)] (II) The eligibility for a reduced service retirement upon completion of a certain length of service;

[(c)] (III) The service retirement allowance of one fifty-fifth of average final compensation;

[(d)] (IV) The retirement allowances provided for ordinary or accidental disability;

[(e)] (V) The selection of options for service or disability allowances;

[(f)] (VI) The adjustment of the retirement allowance for increases in the Consumer Price Index;

[(g)] (VII) The death benefit;

[(h)] (VIII) The level of contributions from members; and

[(i)] (IX) The length of service for members to vest benefits in the system.

(B) A MEMBER WHO IS SUBJECT TO EITHER OF §§ 86B, 86C, OR 86D OF THIS ARTICLE WHO RECEIVES CREDITABLE SERVICE FROM JULY 1, 1984 IS SUBJECT ONLY TO THE PROVISIONS OF THE APPLICABLE SECTION FOR THE PROPORTION OF EARNABLE COMPENSATION THAT IS PAYABLE, THE COMPUTATION OF THE RETIREMENT ALLOWANCE, AND THE ADJUSTMENT OF THE RETIREMENT ALLOWANCE.

86B.

(1) A MEMBER WHO IS IN SERVICE ON JULY 1, 1984 IS SUBJECT TO THE PROVISIONS OF THIS SECTION. A MEMBER WHO IS NOT IN ACTIVE SERVICE ON JULY 1, 1984 BUT WHO IS ELIGIBLE TO RETURN TO ACTIVE SERVICE IS SUBJECT TO THIS SECTION ON THE DATE OF RETURN TO SERVICE.

(2) FROM JULY 1, 1984, A MEMBER SHALL RECEIVE A RETIREMENT ALLOWANCE AS PROVIDED IN THIS SUBSECTION:

(A) FOR RETIREMENT FOR SERVICE, THE RETIREMENT ALLOWANCE IS COMPUTED:

(I) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 86(2)(A) OF THIS ARTICLE; AND

(II) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 145(2) OF THIS ARTICLE;

(B) FOR EARLY RETIREMENT FOR SERVICE, THE RETIREMENT ALLOWANCE IS COMPUTED:

(I) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 86(2)(B) OF THIS ARTICLE; AND

(II) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 145(4) OF THIS ARTICLE;

(C) FOR RETIREMENT FOR ORDINARY DISABILITY, THE INITIAL RETIREMENT ALLOWANCE IS COMPUTED ON THE GREATER OF:

(I) IF THE MEMBER WAS IN SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 86(4) OF THIS ARTICLE; OR

(II) IF THE MEMBER IS IN SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 145(6) OF THIS ARTICLE; AND

(D) FOR RETIREMENT FOR ACCIDENTAL DISABILITY, THE RETIREMENT ALLOWANCE IS COMPUTED:

(I) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED BY § 86(4B) OF THIS ARTICLE; AND

(II) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED BY § 145(8) OF THIS ARTICLE.

(3) A MEMBER WHO RETIRES FROM JULY 1, 1984, SHALL HAVE THE RETIREMENT ALLOWANCE ADJUSTED:

(A) FOR CREDITABLE SERVICE BEFORE JULY 1, 1984, AS PROVIDED IN § 86A OF THIS ARTICLE; AND

(B) FOR CREDITABLE SERVICE FROM JULY 1, 1984, AS PROVIDED IN § 146 OF THIS ARTICLE.

(4) FOR CREDITABLE SERVICE RECEIVED FROM JULY 1, 1984, THE PROPORTION OF THE EARNABLE COMPENSATION PAYABLE BY A MEMBER IS THAT PROVIDED BY § 150(1)(B) OF THIS ARTICLE.

(5) A PROFESSIONAL EMPLOYEE OR FACULTY MEMBER AT ANY INSTITUTION OF HIGHER EDUCATION WHO IS A MEMBER OF THE TEACHERS' RETIREMENT SYSTEM SHALL RETAIN THE RIGHT TO PARTICIPATE IN THE OPTIONAL RETIREMENT SYSTEM ESTABLISHED UNDER § 110 OF THIS ARTICLE.

(6) *(A)* A MEMBER WHO IS SUBJECT TO THIS SECTION MAY TRANSFER TO THE PENSION SYSTEM FOR TEACHERS OF THE STATE OF MARYLAND, AS PROVIDED BY § 142 OF THIS ARTICLE.

(B) ACCUMULATED CONTRIBUTIONS RETURNED TO THE MEMBER AS OF THE DATE OF TRANSFER PURSUANT TO SECTION 14(1)(G) OR SECTION 89(1)(E) OF THIS ARTICLE SHALL BE RETURNED TO THE MEMBER WITH THE AVERAGE RATE OF INTEREST FOR THE 5 YEARS PRECEDING THE YEAR OF TRANSFER COMPOUNDED ANNUALLY. THE RATE OF INTEREST FOR ANY ONE YEAR SHALL BE COMPUTED AS THE SUM OF THE INVESTMENT INCOME AND THE REALIZED GAINS AND LOSSES DIVIDED BY THE BOOK VALUE OF THE INVESTMENTS.

(7) A MEMBER WHO IS SUBJECT TO THIS SECTION WHO AT THE TIME OF RETIREMENT IS

ENTITLED TO MEMBERSHIP SERVICE FOR UNUSED SICK LEAVE UNDER § 85(8) OF THIS ARTICLE SHALL HAVE THE TOTAL AMOUNT OF UNUSED SICK LEAVE APPORTIONED IN THE SAME RATIO THAT THE MEMBER'S CREDITABLE SERVICE IS APPORTIONED FOR CALCULATION OF THE RETIREMENT ALLOWANCE UNDER SUBSECTION (2) OF THIS SECTION.

(8) FOR PURPOSES OF COMPUTING A MEMBER'S RETIREMENT ALLOWANCE:

(A) SERVICE CREDIT RECEIVED BY A MEMBER, OTHER THAN SINCE THE INDIVIDUAL LAST BECAME A MEMBER, SHALL BE TREATED AS CREDITABLE SERVICE AS OF THE DATE THE SERVICE WAS RENDERED. THIS PROVISION DOES NOT APPLY TO SERVICE CREDIT RECEIVED PURSUANT TO ARTICLE 65, SECTION 88; AND

(B) BENEFITS FOR MILITARY SERVICE CREDIT, RECEIVED BY A MEMBER PURSUANT TO ARTICLE 65, SECTION 88, SHALL BE DETERMINED AS OF THE DATE THE BOARD OF TRUSTEES VERIFIES THE CREDIT FOR MILITARY SERVICE.

(9) EXCEPT AS PROVIDED IN THIS SECTION, RETIREMENT UNDER THIS SECTION IS SUBJECT TO THE OTHER APPLICABLE PROVISIONS OF THIS ARTICLE.

86C.

(1) NOTWITHSTANDING THE PROVISIONS OF THIS SUBTITLE, A MEMBER WHO IS IN SERVICE ON JULY 1, 1984 MAY ELECT TO RECEIVE A RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION.

(2) (A) A MEMBER IN SERVICE ON JULY 1, 1984, WHO WISHES TO SELECT THE RETIRE-

MENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL NOTIFY THE TEACHERS' RETIREMENT SYSTEM NOT LATER THAN *JANUARY 1, 1985* OF THE ELECTION ON FORMS PROVIDED BY THE SYSTEM. A MEMBER NOT IN ACTIVE SERVICE ON JULY 1, 1984 BUT WHO IS ELIGIBLE TO RETURN TO ACTIVE SERVICE IN THE SYSTEM SHALL HAVE 90 DAYS FROM THE DATE OF RETURN TO SERVICE TO SELECT THE OPTION PROVIDED IN THIS SECTION.

(B) THE EXECUTIVE DIRECTOR OF THE STATE RETIREMENT AGENCY MAY ACCEPT AN ELECTION UNDER THIS SUBSECTION FILED BY A MEMBER AFTER *JANUARY 1, 1985* OR AFTER THE EXPIRATION OF 90 DAYS FROM RETURN TO SERVICE UPON RECEIPT OF SATISFACTORY PROOF OF GOOD CAUSE FOR DELAY. FAILURE TO RECEIVE NOTICE OR INABILITY TO RESPOND TO NOTICE SHALL CONSTITUTE GOOD CAUSE.

(3) A MEMBER WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL RECEIVE A RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE AS FOLLOWS:

(A) FOR SERVICE RETIREMENT AS PROVIDED BY § 86(2)(A) OF THIS ARTICLE;

(B) FOR EARLY RETIREMENT AS PROVIDED BY § 86(2)(B) OF THIS ARTICLE;

(C) FOR RETIREMENT FOR ORDINARY DISABILITY AS PROVIDED BY § 86(4) OF THIS ARTICLE; AND

(D) FOR RETIREMENT FOR ACCIDENTAL DISABILITY AS PROVIDED BY § 86(4B) OF THIS ARTICLE.

(4) A MEMBER WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL HAVE THE RETIREMENT ALLOWANCE ADJUSTED AS FOLLOWS:

(A) FOR ALL FISCAL YEARS BEGINNING THE SECOND JULY 1 FOLLOWING THE DAY PRECEDING THE MEMBER'S DATE OF RETIREMENT, THE RETIREMENT ALLOWANCE PAID DURING THE PRIOR FISCAL YEAR, EXCLUSIVE OF ANY ADDITIONAL VOLUNTARY ANNUITY, SHALL BE ADJUSTED BY THE PERCENTAGE CALCULATED BY THE CONSUMER PRICE INDEX FOR THE CALENDAR YEAR ENDING DECEMBER 31 IN THE PRECEDING FISCAL YEAR DIVIDED BY THE CONSUMER PRICE INDEX FOR THE CALENDAR YEAR ENDING DECEMBER 31 IN THE SECOND PRECEDING FISCAL YEAR;

(B) THE ADJUSTMENT PROVIDED FOR IN PARAGRAPH (A) OF THIS SUBSECTION (4) SHALL NOT EXCEED 5 PERCENT OF THE ANNUAL RATE OF RETIREMENT ALLOWANCE PAID DURING THE PRIOR FISCAL YEAR;

(C) FOR PURPOSES OF THIS SUBSECTION (4), CONSUMER PRICE INDEX SHALL MEAN THE CONSUMER PRICE INDEX, U.S. CITY AVERAGE—ALL URBAN CONSUMERS AS OF DECEMBER 31 AS PUBLISHED BY THE UNITED STATES DEPARTMENT OF LABOR;

(D) THE TOTAL RETIREMENT ALLOWANCE PAYABLE IN EACH FISCAL YEAR SHALL BE THE SUM OF:

(I) THE MEMBER'S ANNUAL RATE OF RETIREMENT ALLOWANCE PAID DURING THE PRIOR FISCAL YEAR;

(II) THE ADJUSTMENT IN RETIREMENT ALLOWANCE PROVIDED FOR UNDER THIS SUBSECTION (4); AND

(III) ANY ADDITIONAL VOLUNTARY ANNUITY; AND

(E) THE ALLOWANCE OF A SURVIVING BENEFICIARY OF A MEMBER OR A RETIRED MEMBER, SHALL, WHEN AND IF PAYABLE, BE ADJUSTED IN THE SAME MANNER AS PROVIDED IN THIS SUBSECTION.

(5) FOR CREDITABLE SERVICE FROM JULY 1, 1984, THE PROPORTION OF THE EARNABLE COMPENSATION PAYABLE BY A MEMBER WHO SELECTS THE OPTION PROVIDED IN THIS SECTION SHALL CONTINUE TO BE THAT PROVIDED BY § 89(1)(A) OF THIS ARTICLE.

(6) A MEMBER WHO SELECTS THE OPTION PROVIDED IN THIS SECTION MAY AFTER SELECTION OF THIS OPTION:

(A) TRANSFER TO THE PENSION SYSTEM FOR TEACHERS OF THE STATE OF MARYLAND AS PROVIDED BY § 142 OF THIS ARTICLE; OR

(B) ACCUMULATED CONTRIBUTIONS RETURNED TO THE MEMBER AS OF THE DATE OF TRANSFER PURSUANT TO SECTION 14(1)(G) OR SECTION 89(1)(E) OF THIS ARTICLE SHALL BE RETURNED TO THE MEMBER WITH THE AVERAGE RATE OF INTEREST FOR THE 5 YEARS PRECEDING THE YEAR OF TRANSFER COMPOUNDED ANNUALLY. THE RATE OF INTEREST FOR ANY ONE YEAR SHALL BE COMPUTED AS THE SUM OF THE INVESTMENT INCOME AND THE REALIZED GAINS AND LOSSES DIVIDED BY THE BOOK VALUE OF THE TOTAL INVESTMENTS; OR

(B) *(C)* SELECT A RETIREMENT ALLOWANCE AS PROVIDED IN § 86B OF THIS ARTICLE AND THE PROPORTION OF EARNABLE COMPENSATION PAYABLE AS PROVIDED IN *150(1)(B)* OF THIS ARTICLE WITH THE EFFECTIVE DATE OF THE SELECTION BEING SUBSTITUTED FOR JULY 1, 1984. THE ADJUSTMENT TO THE RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE PRIOR TO THE DATE OF SELECTION SHALL BE CALCULATED AS PROVIDED IN SUBSECTION (4) OF THIS SECTION AND NOT AS PROVIDED IN § 86A OF THIS ARTICLE. THE ADJUSTMENT TO THE RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE AFTER THE EFFECTIVE DATE OF SELECTION SHALL BE CALCULATED AS PROVIDED BY § 146 OF THIS ARTICLE.

(7) A PROFESSIONAL EMPLOYEE OR FACULTY MEMBER AT ANY INSTITUTION OF HIGHER EDUCATION WHO IS A MEMBER OF THE TEACHERS RETIREMENT SYSTEM SHALL RETAIN THE RIGHT TO PARTICIPATE IN THE OPTIONAL RETIREMENT SYSTEM ESTABLISHED UNDER § 110 OF THIS ARTICLE.

(8) EXCEPT AS PROVIDED IN THIS SECTION, RETIREMENT UNDER THIS SECTION IS SUBJECT TO THE OTHER APPLICABLE PROVISIONS OF THIS ARTICLE.

86D.

(1) NOTWITHSTANDING THE PROVISIONS OF THIS SUBTITLE, A MEMBER WHO IS IN SERVICE ON JULY 1, 1984 MAY ELECT TO RECEIVE A RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION.

(2) (A) A MEMBER IN SERVICE ON JULY 1, 1984 WHO WISHES TO SELECT THE RETIREMENT

ALLOWANCE AS PROVIDED IN THIS SECTION SHALL NOTIFY THE TEACHERS' RETIREMENT SYSTEM NOT LATER THAN *JANUARY 1, 1985* OF THIS ACTION ON FORMS PROVIDED BY THE SYSTEM. A MEMBER NOT IN SERVICE ON JULY 1, 1984 BUT WHO IS ELIGIBLE TO RETURN TO SERVICE IN THE SYSTEM SHALL HAVE 90 DAYS FROM THE DATE OF RETURN TO SERVICE TO SELECT THE OPTION PROVIDED IN THIS SECTION.

(B) THE EXECUTIVE DIRECTOR OF THE STATE RETIREMENT AGENCY MAY ACCEPT AN ELECTION UNDER THIS SUBSECTION FILED BY A MEMBER AFTER *JANUARY 1, 1985* OR AFTER THE EXPIRATION OF 90 DAYS FROM RETURN TO SERVICE UPON RECEIPT OF SATISFACTORY PROOF OF GOOD CAUSE FOR DELAY. FAILURE TO RECEIVE NOTICE OR INABILITY TO RESPOND TO NOTICE SHALL CONSTITUTE GOOD CAUSE.

(3) A MEMBSR WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL RECEIVE A RETIREMENT ALLOWANCE FOR ALL CREDITABLE SERVICE AS FOLLOWS:

(A) FOR SERVICE RETIREMENT AS PROVIDED BY § 86(2)(A) OF THIS ARTICLE;

(B) FOR EARLY RETIREMENT FOR SERVICE AS PROVIDED BY § 86(2)(B) OF THIS ARTICLE;

(C) FOR RETIREMENT FOR ORDINARY DISABILITY AS PROVIDED BY § 86(4) OF THIS ARTICLE; AND

(D) FOR RETIREMENT FOR ACCIDENTAL DISABILITY AS PROVIDED BY § 86(4B) OF THIS ARTICLE.

(4) A MEMBER WHO SELECTS THE RETIREMENT ALLOWANCE AS PROVIDED IN THIS SECTION SHALL HAVE THE RETIREMENT ALLOWANCE ADJUSTED AS PROVIDED IN § 86A OF THIS ARTICLE.

(5) FOR CREDITABLE SERVICE FROM JULY 1, 1984, THE PROPORTION OF EARNABLE COMPENSATION PAYABLE AS PROVIDED BY § 89(1)(A) OF THIS ARTICLE SHALL BE INCREASED BY AN ADDITIONAL 2 PERCENT OF EARNABLE COMPENSATION.

(6) A MEMBER WHO SELECTS THE OPTION PROVIDED IN THIS SECTION MAY AFTER SELECTION OF THIS OPTION:

(A) TRANSFER TO THE PENSION SYSTEM FOR TEACHERS OF THE STATE OF MARYLAND AS PROVIDED BY § 142 OF THIS ARTICLE:

(B) ACCUMULATED CONTRIBUTIONS RETURNED TO THE MEMBER AS OF THE DATE OF TRANSFER PURSUANT TO SECTION 14(1)(G) OR SECTION 89(1)(E) OF THIS ARTICLE SHALL BE RETURNED TO THE MEMBER WITH THE AVERAGE RATE OF INTEREST FOR THE 5 YEARS PRECEDING THE YEAR OF TRANSFER COMPOUNDED ANNUALLY. THE RATE OF INTEREST FOR ANY ONE YEAR SHALL BE COMPUTED AS THE SUM OF THE INVESTMENT INCOME AND THE REALIZED GAINS AND LOSSES DIVIDED BY THE BOOK VALUE OF THE TOTAL INVESTMENTS;

(C) SELECT A RETIREMENT ALLOWANCE AS PROVIDED IN § 86C OF THIS ARTICLE. THE INCREASE IN THE PROPORTION OF EARNABLE COMPENSATION PAYABLE AS PROVIDED IN SUBSECTION (5) OF THIS SECTION SHALL NOT BE REFUNDED; OR

(C) *(D)* SELECT A RETIREMENT ALLOWANCE AS PROVIDED IN § 86B OF THIS ARTICLE, THE ADJUSTMENT AS PROVIDED IN *86B(3)* OF THIS ARTICLE, AND THE PROPORTION OF EARNABLE COMPENSATION THAT IS PAYABLE AS PROVIDED IN § 150(1)(B) OF THIS ARTICLE, WITH THE EFFECTIVE DATE OF THE SELECTION BEING SUBSTITUTED FOR JULY 1, 1984.

(7) A PROFESSIONAL EMPLOYEE OR FACULTY MEMBER AT ANY INSTITUTION OF HIGHER EDUCATION WHO IS A MEMBER OF THE TEACHERS' RETIREMENT SYSTEM SHALL RETAIN THE RIGHT TO PARTICIPATE IN THE OPTIONAL RETIREMENT SYSTEM ESTABLISHED UNDER § 110 OF THIS ARTICLE.

(8) EXCEPT AS PROVIDED IN THIS SECTION, RETIREMENT UNDER THIS SECTION IS SUBJECT TO THE OTHER APPLICABLE PROVISIONS OF THIS ARTICLE.

Chapter 23 of the Acts of 1979

SECTION 3. AND BE IT FURTHER ENACTED, That, EXCEPT AS MODIFIED BY CHAPTER — OF THE ACTS OF 1984 (S.B. —— OR H.B. —— (41r 1916)) it is the intention of the General Assembly in adopting this Act that any benefits which any beneficiary under the Employees' Retirement System or the Teachers' Retirement System is receiving prior to the effective date of this Act are not affected, altered or changed in any manner by the adoption of this Act. It is also the intention of the General Assembly that nothing in this Act shall affect, alter or change any of the rights or benefits of any person who is a member of the Employees' Retirement System and the Teachers' Retirement System on December 31, 1979 unless the member exercises the choice of joining the new system created by this Act.

Chapter 24 of the Acts of 1979

SECTION 3. AND BE IT FURTHER ENACTED, That, EXCEPT AS MODIFIED BY CHAPTER — OF THE ACTS OF 1984 (S.B. —— OR H.B. —— (41r 1916)) it is the intention of the General Assembly in adopting this Act that any benefits which any beneficiary under the Employees' Retirement System or the Teachers' Retirement System is receiving prior to the effective date of this Act are not affected, altered or changed in any manner by the adoption of this Act. It is also the intention of the General Assembly that nothing in this Act shall affect, alter or change any of the rights or benefits of any person who is a member of the Employees' Retirement System and the Teachers' Retirement System on December 31, 1979 unless the member exercises the choice of joining the new system created by this Act.

SECTION 2. AND BE IT FURTHER ENACTED, That it is the intent of the General Assembly that, for fiscal year 1985, savings realized from cost reductions pursuant to the provisions of this Act shall be retained in the Maryland State Retirement and Pension Systems Trust Fund for the purpose of reducing the Systems' unfunded accrued liability. For fiscal year 1985, the appropriations provided for the Employees' Retirement System (budget code 26.10.00.03) and the Teachers' Retirement System (budget code 26.10.00.05) in the amounts of $74,978,709 and $285,675,926, respectively, shall be used only for the purposes therein appropriated and there shall be no budgetary transfer by budgetary amendment or otherwise from those programs to any other program or purpose. None of these appropriated funds shall be reverted to the General Fund of the State at the close of fiscal year 1985.

SECTION 3. AND BE IT FURTHER ENACTED, That, the Board of Trustees shall notify each member of

the Employees' Retirement System and the Teachers' Retirement System of the amendments to the benefit structure as provided in Section 1 of this Act, the notice to include the forms necessary to select the options as provided in the benefit structure. This notification shall occur prior to June 15, 1984.

SECTION 4. AND BE IT FURTHER ENACTED, That this Act shall take effect June 1, 1984.

Approved April 10, 1984.

APPENDIX H

MARYLAND ANNOTATED CODE

Article 73B, Sections 3(9) and 83(9),
As Enacted In 1979

The membership of the retirement system shall consist of the following:

(9) Any person who is a member of the retirement system, established by this subtitle, on December 31, 1979 and does not at any time elect to be a member of the Pension System for Employees [or Teachers] of the State of Maryland, shall, as a condition of that person's employment contract, be entitled to remain a member of the retirement system without change in the benefits provided in the retirement system as of December 31, 1979. Any person receiving benefits under the provisions of this subtitle on December 31, 1979 shall continue to receive the benefits as provided in the retirement system as of December 31, 1979. These benefits shall include but not be limited to:

(a) The eligibility for service retirement upon completion of 30 years service or attainment of age 60;

(b) The eligibility for a reduced service retirement upon completion of a certain length of service;

(c) The service retirement allowance of one fifty-fifth of average final compensation;

(d) The retirement allowances provided for ordinary or accidental disability;

(e) The selection of options for service or disability allowances;

(f) The adjustment of the retirement allowance for increases in the Consumer Price Index;

(g) The death benefit;

(h) The level of contributions from members; and

(i) The length of service for members to vest benefits in the system.

No. 85-1465

Supreme Court, U.S.
FILED
APR 3 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

MARYLAND STATE TEACHERS ASSOCIATION, INC., ET AL.,
Petitioners,

v.

HARRY HUGHES, GOVERNOR OF MARYLAND, ET AL.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF IN OPPOSITION

STEPHEN H. SACHS,
Attorney General of Maryland,
DIANA G. MOTZ,
SUSAN K. GAUVEY,
LINDA H. LAMONE,
CAROL S. SUGAR,
KATHRYN M. ROWE,
ROBERT A. ZARNOCH,
(Counsel of Record),
Assistant Attorneys General,
90 State Circle,
Annapolis, Maryland 21401,
(301) 841-3889,
Attorneys for Respondents.

The Daily Record Co., Baltimore, MD 21202

QUESTIONS PRESENTED

1. Whether public employees and teachers could reasonably and legitimately rely upon a purported statutory contract of "no change" in certain future pension benefits, where the pre-existing Maryland caselaw and other relevant "law of the place" incorporated into the alleged contract permitted legislative change and the area of pension costs and benefits continued to remain pervasively regulated and heavily troubled?

2. Whether Maryland's pension law changes could be deemed a severe and retroactive contract impairment, even though the Legislature did not affect prior earned benefits or most future benefits of employees and teachers, who, in fact, were compensated by pay increases that translated into higher pension benefits and by improvements to the integrity, flexibility and actuarial and fiscal soundness of the retirement systems?

3. If the statute is found to severely and retroactively impair a purely financial obligation outside the State's reserve powers, whether the legislation is nevertheless justified as reasonable and necessary to insure the stability of the retirement systems and the State's fiscal health?

4. Whether the judgment below should be affirmed on the alternative grounds (1) that no binding statutory contract was created; (2) that the employees and teachers furnished no consideration for a contract; (3) that the alleged contract was subject to a condition of reasonable containment of rising pension costs, a condition that, by 1984, had failed as a result of unforeseen developments; and (4) that the Petitioners were justly compensated for the impact of pension law changes?

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No. 85-1465

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

MARYLAND STATE TEACHERS ASSOCIATION, INC., ET AL.,
Petitioners,

v.

HARRY HUGHES, GOVERNOR OF MARYLAND, ET AL.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF IN OPPOSITION

Governor Harry Hughes, et al., Respondents, for reasons detailed herein, urge the Court to deny issuance of a writ of certiorari to the United States Court of Appeals for the Fourth Circuit to review the judgment in *MSTA v. Hughes*, ___ F.2d ___, No. 84-2213 (4th Cir. Dec. 5, 1985).

STATEMENT OF THE CASE

After years of study and of employee opposition to pension reform, the Maryland General Assembly in 1979 enacted comprehensive legislation in an attempt to control the runaway costs of the State Employees' and Teachers' Retirement Systems. Chapters 23 and 24, Laws of Maryland (1979). This statute (1) required advance-funding of future State pension liabilities; (2) established

for employees and teachers hired after December 31, 1979, a generally noncontributory "pension" system with a modified benefit schem., including a capped cost-of-living adjustment (COLA), and with integration of benefits with social security; and (3) sought to encourage transfers to the new system by "retirement" system members via a return of contributions.[1]

When the 1979 legislation was being considered by House and Senate Committees, public employee unions sought amendments in an attempt to assure their membership that no future changes to benefit plans of old system members would occur. Before voting to approve the amendments, the Committees sought advice from the State Attorney General's Office that the proposals would not preclude future legislative changes, including modi-

[1] As was the case prior to 1979, members of the State employees' and teachers' "retirement" systems (including employees of participating municipal corporations) contributed five percent or less of their salary to an "annuity" which, coupled with the totally State-funded "pension", formed their "retirement allowance." *See* Article 73B, § 1(16), (17), and (18), and § 81(16), (17), and (18). Eligibility for service retirement was obtained upon 30 years of service or at age 60 and a right to some retirement allowance "vested" upon five years service. Art. 73B, § 11(16) and § 86(10). That retirement allowance was computed by multiplying 1/55th (1.82 percent) of the member's "average final compensation" (his or her three highest salary years) by the number of years of creditable service. Special provisions also existed in the law as to death and disability benefits as well as an automatic, unlimited cost-of-living adjustment for retirees. Prior to 1969, the employee-funded "annuity" and the State-funded "pension" were set at equal amounts. For example, when the percentage applied to average final compensation was 1/70th (1.43 percent), that amount was based upon a 1/140th share from both the State and the member. However, since 1969, the employee's share remained at 1/140th, while the State provided additional funds in the budget for the employee's share as an "additional pension." In addition, since its inception in 1971, the COLA has been funded entirely by the State from appropriated funds, not by a member's contributions. JLEC Report at 26.

fication of the unlimited COLA. On February 22, 1979, the General Assembly's lawyer responded in writing by pointing to a 1976 Opinion of the Attorney General (61 *Opinions of the Attorney General* 746 (1976)), sanctioning even more stringent proposals, and the Court of Special Appeals opinion in *City of Frederick v. Quinn*, 35 Md. App. 626, 371 A.2d 724 (1977), on the legislative right to alter municipal pension plans. On the basis of this authority, the letter concluded that even earned pension benefits were subject to a reserved legislative power to make reasonable modifications "for the purpose of keeping the system flexible and maintaining its integrity" and that "this rule would also apply to legislative changes affecting cost-of-living adjustments, regardless of when the employee retires." As to future pension earnings, the letter noted that "the Legislature could modify such pension rights before they become a vested property right without regard to justifications rooted in fiscal integrity or reasonable modifications." *See MSTA v. Hughes*, 594 F. Supp. 1353, 1364 (D. Md. 1984).

Following the receipt of this advice, House and Senate committees adopted the amendments proposed by the unions, which provided that members of the old retirement systems, as of December 31, 1979, who did not join the new pension system, would remain in the old system "as a condition of that person's employment contract . . . without change in . . . benefits."[2] Despite

[2] The amendment, which amounted to less than two pages of a 80-page bill, went on to provide that the relevant benefits included: (1) The eligibility for service retirement upon completion of 30 years service or attainment of age 60; (b) The eligibility for a reduced service retirement upon completion of a certain length of service; (c) The service retirement allowance of one fifty-fifth of average final compensation; (d) The retirement allowance provided for ordinary or accidental disability; (e) The selection of options for service or disability allowance; (f) The adjustment of the retirement allowance for increases in the consumer price index; (g) The death benefit; (h) The level of contributions from members; and (i) The length of service for members to vest benefits in the system.

the amendments, union opposition to the measure persisted. However the legislation was enacted.

Spread across the legislative record and included in reports, fiscal notes and actuarial analyses were the 1979 General Assembly's hopes for pension reform and its reasonable expectations as to future State costs, transfers into the new system, inflation, and the non-precipitous growth of unfunded accrued pension liabilities. *See* 1979 House Journal 1385-1413. For example, a "fiscal note" prepared for the legislation[3] disclosed that total costs of all the retirement and pension systems as a percentage of payroll would level off at 11.66 percent and continue at that rate through the year 2020 and that dollar costs would range from $254.3 million in Fiscal 1981, to $345.8 million by fiscal year 1985. 1979 House Journal 1398. Additional annual costs as a result of the legislation were forecast at $32.1 million for fiscal year 1981 up to $35.9 million in the mid-eighties, with a drop in net costs occurring sometime before the year 2000. *Id.* It was also forecast that the unfunded accrued liability of the systems, which, as of June 30, 1978, valuation stood at $2.8 billion, 1979 House Journal at 1412, would not reach $5 billion until the year 2000. According to the fiscal notes, "[a] key assumption used in the actuarial analysis is that approximately 40 percent of the present membership in the Employees and Teachers Pension Systems will elect to transfer to the new systems." 594 F. Supp. at 1365. With the stability forecast in these figures, it was no wonder that the Governor in his end-of-session message to the 1979 General Assembly could say that "by reforming a runaway State pension system," what we have accom-

[3] Pension bills are ordinarily required by law to contain a fiscal note containing an estimate of the fiscal impact and an actuarial analysis of the legislation. *See* Md. Code, State Government Article, § 2-1505. Generally, a vote may not be taken on such legislation by a standing committee without a fiscal and actuarial analysis. *Id.*

plished "is to begin the process of laying a foundation for sound fiscal planning and management for the years to come." 1979 House Journal at 3953.[4]

These expectations were soon dashed. First, as State officials advised New York bond rating houses of the new stability of the Maryland retirement systems, public employee unions began a successful campaign to keep old system members from transferring into the new system. As a result, only 18 percent of teachers and 32 percent of State employees opted for the new system. 594 F. Supp. at 1365.

Second, a 1980 "experience investigation" by the State's actuary of the teachers' retirement system disclosed that certain actuarial assumptions embodied in the 1979 cost projections were incorrect and that teachers were retiring earlier in greater numbers to obtain the unlimited COLA. This necessitated an increase in the State's contribution of 3.42 percent of payroll phased in over a three-year period. 594 F. Supp. at 1365.

Third, because of a drafting error in the 1979 legislation and because of the different demographic characteristics of their workforce, municipal corporations participating in the State retirement system suddenly faced millions of dollars more in unexpected costs. And a moratorium had to be imposed administratively on municipality payments to the system. 594 F. Supp. at 1366.

Fourth, in 1981, the State's actuary advised that the 1979 projection of costs erroneously computed the COLA for retirement system members on a simple rather than a compound basis. 594 F. Supp. at 1366. The error was not

[4] Shortly after the legislation was enacted and before it took effect, the General Assembly took the additional step of establishing a Joint Committee on Pensions "to continue the study of pension reform and to propose necessary future legislation."

just a one-year problem. It essentially required more than a $30 million increase in the 1983 fiscal year State budget and comparable amounts for State advance funding of pension costs for the next 40 years, or an estimated $1.2 billion. *Id.* at n.7. Unfunded accrued liabilities for the systems for a single year immediately increased by $578 million. *Id.* In addition, $16 million in higher appropriations had to be found in the 1982-83 budget to pay for these costs, thereby causing a cut-back in anticipated State spending for social welfare.

Further aggravating the COLA problem was a totally unexpected and drastic increase in inflation. On the basis of the Labor Department CPI, retirees received increases of 11.3 percent in 1981, 13.5 percent in fiscal 1982, and 10.4 percent in fiscal 1983.[5] Report of Joint Legislative and Executive Committee on Pensions (JLEC Report) at 27. These were increases that dwarfed the actuary's reasonable (and present) assumption of five percent and generated an enormous actuarial loss, escalation of unfunded accrued liabilities, and higher annual appropriations for pension costs. The end result of these developments was a quarter of a billion dollar difference between 1979 projected State costs and actual costs as of fiscal year 1984. Unfunded accrued liabilities exceeded $5 billion, JLEC Report at 63 — almost 20 years earlier than anticipated.[6] In December 1982, the State was told by its

[5] When the "two-tiered" pension system proposal was taking shape in the General Assembly in the late seventies, inflation was at a moderate rate. Although the cost-of-living rose in 1979 when the pension reform legislation was being enacted, various economists and even the President were forecasting a reduction in inflation. *See e.g. 1979 Public Papers of President Jimmy Carter, News Conference of Feb. 12, 1979* at 156.

[6] State unfunded accrued liabilities per active member rose from $19,831 in 1980 to $34,512 in 1983. JLEC Report at 67. In addition, by 1983, Maryland ranked second in the Nation with a per capita unfunded pension liability burden of $1,256.82 — higher than the per capita tax burden, the per capita State debt burden, or per capita State expenditures. *See* Prudential-Bache

actuary that an additional $103 million in appropriations was needed to fund the various retirement and pension systems in fiscal year 1984. JLEC Report at 55. As a result, the Governor announced that there would be no State employee pay increase that year and less money for social services and other programs. In addition, agency spending cuts were ordered.

The very next session, Senate Bill 606, which would have computed future years' benefits for employees and teachers in the old system in accordance with the new system formula (including a three percent COLA), was introduced and was passed in the Senate over union opposition. However, the House refused to act upon the bill, claiming that the issue deserved further study and that pension changes should not occur without an employee pay increase. After the failure of Senate Bill 606, the Governor named a Joint Legislative and Executive Committee on Pensions ("JLEC"), composed of legislative veterans of past pension reform efforts and certain executive branch officials, as well as an advisory body consisting of members of the employees' unions, to address a wide range of pension reform and cost containment issues. Executive Order 01.01.1983.10. Before the JLEC issued its recommendations, members of the House suggested and the Committee adopted a compromise of the 1983 legislation — a "menu" of options for old system members (none of which affected existing retirees), including a two percent increase in employee contributions that would preserve all benefits including an unlimited COLA.[7]

Securities, *A Special Report: The Fifty States — Financial Condition and Economic Outlook* (Sept. 1983) at 50-51.

[7] Under the "menu" approach, old system members were offered four choices: (1) the "bifurcated" option embodied in Senate Bill 606 of 1983, *viz.*, preservation of all prior years' benefits already earned under the old system with future years computed under the new, noncontributory system; (2) continued

In addition to the COLA legislation (H.B. 991, enacted into law as Chapter 7, 1979 Laws of Maryland), the JLEC proposed a number of additional reforms clearly designed to benefit employees. JLEC Report at 1. These included removing certain pension fund investment limitations, using contributions from the new systems to insure the solvency of the old, changing the actuarial cost method to stabilize future funding and extending a moratorium on the accrued liability payments of local governments participating in the State systems. (H.B. 1664, enacted into law as Chapter 290, 1984 Laws of Maryland). The Administration proposed this comprehensive pension reform package along with a six percent pay raise for State employees and a five-year commitment of State spending for education. A large portion of the latter was clearly intended for teacher salary increases that by operation of law acted to raise pension benefit levels. *See* Md. Code, Art. 73B, § 1(15) and § 81(15). Despite intense opposition by teachers and employees House Bill 991 was enacted, clearing the way for passage of House Bill 1664 and these pay initiatives.[8]

On April 10, 1984, six employee unions and 19 teachers and public employees brought a class action in the United States District Court in Maryland challenging only one

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contribution of five percent with a five percent COLA cap; (3) retention of the unlimited COLA but an additional contribution of two percent; and (4) transfer to the new system with a refund of contributions. If a member failed to make any choice by the cut-off date, his or her benefits would automatically be bifurcated. Just as was the case under Senate Bill 606, the "menu" approach did not affect the benefits of those who retired before the effective date of the legislation.

[8] Before passage, the bill was amended in ways designed to additionally benefit the members of the system. One amendment required the savings from the first year to be applied to the unfunded accrued liability. A second amendment increased the interest paid on the return of contributions to members who chose to transfer to the pension systems.

component of this pension reform and salary enhancement package for State employees and teachers, *viz.* House Bill 991. Their principal contention was that the bill unconstitutionally impaired a contract purportedly created in 1979. In return for agreement to an expedited schedule, and, if the State prevailed, post-judgment implementation of the statute in accordance with its July 1, 1984 effective date, the State consented to the entry of a preliminary injunction halting operation of the law. Cross motions for summary judgment were filed and following argument, the Court, in a September 17, 1984 order, granted the State's motion. On September 25, 1984, the Court issued an opinion which concluded that if a contract had been created in 1979, it was not impaired by the 1984 legislation. *MSTA v. Hughes,* 594 F. Supp. 1353 (D. Md. 1984). Apparently, to avoid reconciling Maryland court decisions that undercut the existence of a statutory contract of "no change" in State pension benefits,[9] with a

[9] In *Mazor v. Dept. of Corrections,* 30 Md. App. 394, 352 A.2d 918 (1976), *aff'd* 279 Md. 355, 369 A.2d 82 (1977), the Court of Special Appeals of Maryland held that because of the clear distinction in Article 73B of the Maryland Code between a State funded "pension" and an "annuity" based on employee contributions, a State pension was a gratuity not a contract, even in the face of statutory language making a pension and an annuity "obligations of the State." The State's highest court affirmed. Relying upon *Flemming v. Nestor,* 363 U.S. 603 (1960), the judges noted:

> "To engraft upon the pension . . . program . . . a concept of accrued property rights would deprive these programs of the 'flexibility and boldness in adjustment to ever-changing conditions' which they demand." 279 Md. at 366, 369 A.2d at 90.

Other Maryland cases also cast doubt on Petitioners' statutory contract, of "no change" in benefits, *viz., Westminster Water Co. v. Westminster,* 98 Md. 551, 56 A. 99 (1904) (A permanent contract binding legislative powers is *ultra vires*); *Kimball-Tyler v. Baltimore City,* 214 Md. 86, 133 A.2d 433 (1957) (Detrimental reliance is insufficient consideration to support a statutory contract); *Canal Co. v. Rail Road Co.,* 4 G. & J 1 (1832) (Use of word "contract" is irrelevant on whether a contract exists); and

1977 intermediate appellate court decision that concluded that a municipal pension was a contract protecting earned benefits but one subject to a reserved legislative power to change, *City of Frederick v. Quinn,* 35 Md. App. 626, 371 A.2d 724 (1977), the District Court assumed "without deciding" that a contract existed, *MSTA v. Hughes, supra,* 594 F. Supp. at 1362. Incorporating *Quinn* into the employees' and teachers' asserted contract, the Court held that it was subject to legislative change and protected no more than pro rata earned benefits. In light of this latter feature of the contract, the Court concluded the 1984 statute resulted in neither a retroactive nor a severe impairment. 594 F. Supp. at 1362-1364.[10] The Court also stated that *if* the employees' and teachers' contract of no change was immutable, the State would have surrendered an essential attribute of State sovereignty, *viz.* control over compensation for future services. 594 F. Supp. at 1362 and 1364. However, the Court added that "the plaintiffs, presumably recognizing the preposterousness of a position that a contract of this type is irrevocable, admit that the contract asserted to exist here may be altered."

Rittenhouse v. Baltimore, 25 Md. 336, 346 (1886) (No contract obligation arises from those acts "necessarily connected with or growing out of [the governmental entity's] public capacity.").

[10] The Court also found no severe impairment as a factual matter. It specifically rejected Petitioners' contentions that the "menu" option increasing the contribution rate from five to seven percent resulted in a 40 percent rate increase. Quoting from the affidavit of the State's actuarial expert, the Court said:

> "Past contributions made by the affected members are not adjusted; for example, a member who has already contributed to the Retirement System at 5% for twenty-five years and has five years to go would only contribute an additional 12% (rather than 40%) in *total* contributions." 594 F. Supp. at 1364.

The Court also emphasized the conclusions of the State's actuary that using the methodology and assumptions of Petitioners' expert, "the 'worst case scenario' of the 7% option results in a *maximum* benefit loss of well under two percent for any current member of the Retirement Systems." *Id.*

594 F. Supp. at 1362. Finally, the Court concluded that even if the impairment were substantial, the 1984 pension reform legislation was reasonable and necessary to serve important public purposes, such as enhancing the actuarial soundness of the retirement systems, the predictability of its costs, and State planning of its fiscal strategies. *Id.* at 1369-1370.[11] On December 5, 1985, the United States Court of Appeals for the Fourth Circuit affirmed in a brief per curiam opinion, with all judges in agreement that the State had acted in good faith and had justified the need for pension law changes. *See* concurring opinion of Judge Murnaghan. *See* Petition for Writ of Certiorari at 5a-6a.

ARGUMENT

I.

NO SUBSTANTIAL FEDERAL QUESTION IS PRESENTED BY THE LOWER COURT'S DECISION THAT THE MARYLAND CASELAW THAT FORMED PART OF THE PURPORTED STATUTORY CONTRACT PERMITTED THE LEGISLATIVE MODIFICATIONS AT ISSUE.

This Court has long held that in determining the existence and extent of a statutory contract alleged to be protected by Article I, § 10 of the United States Constitution, it "will treat it as if there was embodied in their text the settled rule of law which existed in the state at the time the state action relied upon as a contract was taken." *Ennis Water Works v. Ennis,* 233 U.S. 652, 657-658 (1914); *see also United States Trust Co. v. New Jersey,* 431 U.S. 1, 19, n.17 (1977); *Von Hoffman v. City of Quincy,* 4 Wall. 535, 550 (1867). Although the petition for

[11] Following the District Court decision, the State announced plans to implement the 1984 law with a six-month election period beginning November 11 1984, and to return old system members to the status quo should it not prevail on appeal. Upon representation of this arrangement to the Court, the District Judge denied Petitioners' request for a stay. Thus, the 1984 legislation has been in effect for nearly 18 months.

certiorari gives little hint of it, this principle, along with the strong factual justification offered by the State in support of the 1984 pension law changes, determined the outcome below. In short, Maryland caselaw, most notably, *City of Frederick v. Quinn,* 35 Md. App. 626, 371 A.2d 724 (1977), permitted legislative modification of a pension "contract" in Maryland and sanctioned the statutory changes attacked by Petitioners.[12]

The state common law governing public employee pension rights and the legislative power to alter benefits varies from jurisdiction to jurisdiction. Some state courts cling to the notion that a public employee pension is not a contract but a gratuity that can be altered at the Legislature's will. *See e.g., Creps v. Board of Firemen's Relief and Retirement Fund Trustees,* 456 S.W.2d 434 (Tex. Civ. App. 1970). However, in contrast to the treatment of federal retirees, *see Zucker v. United States,* 758 F.2d 637 (Fed. Cir. 1985), *cert. denied,* 106 S. Ct. 129 (1985), the clear trend of state court decisions is to offer some measure of protection for employee pension rights. A few courts hold that pensions are contractual in the sense that rights vest unconditionally and may not be legislatively altered even to make plans more fiscally sound. *See e.g., Yeazell v. Copins,* 402 P.2d 541 (Ariz. 1965). Others reject this rigid "contract" approach in favor of treating pensions as a "property right," *see e.g., Pineman v. Oechslin,* 488 A.2d 803 (Conn. 1985) or as governed by a theory of "promissory estoppel," *Christensen v. Minneapolis Municipal Employees Retirement Board,* 331 N.W.2d 740 (Minn. 1983). A growing number of jurisdictions characterize a pension as a contract, but one permitting only limited vesting rights and containing an

[12] In addition to the Maryland cases, various provisions of the Maryland Constitution and statutes undercut the Petitioners' ability to rely on a contract of no-change in future benefits. *See* n.16, *supra.*

implied term reserving legislative power to make reasonable modifications. *See e.g., Lyon v. Flouring,* 76 Cal. Rptr. 869 (Cal. App. 1969), *appeal dismissed for want of a substantial federal question,* 396 U.S. 274 (1970).[13]

Even those state courts that treat a public employee pension as a contract or subject to reasonable modification differ as to what rights are protected by the contract and what modifications are permitted. For example, some state courts permit an increase in employee contributions, *see e.g., Houghton v. City of Long Beach,* 330 P.2d 918 (Cal. App. 1958); others do not, *Association of Pennsylvania State College and University Faculty v. State System of Higher Education,* 479 A.2d 962 (Pa. 1984). Some jurisdictions protect only accrued or earned benefits, *see e.g., In re Enrolled Senate Bill 1269,* 209 N.W.2d 200 (Mich. 1973); others protect some future benefits, *Pasadena Pol. Off. Ass'n v. City of Pasadena,* 195 Cal. Rptr. 339 (Cal. App. 1983). Some courts hold that a pension contract does not prevent reduction of appropriations for such plans, *see e.g., Illinois Fed. of Teachers v. Lindberg,* 326 N.E.2d 749 (Ill. 1975), *cert. denied,* 423 U.S. 839 (1975); others reach an opposite conclusion, *see Valdez v. Cory,* 189 Cal. Rptr. 212 (Cal. App. 1983). Some say there are no pension rights until all eligibility requirements, including years of service, are satisfied, *McFeely v. Pension Comm'n,* 73 A.2d 757 (N.J. Super. 1950); others hold that rights vest upon employment, *Smith v. City of Dothan,* 188 So. 2d 532 (Ala. 1966).[14]

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[13] The apparent forerunner of the "reasonable modification" approach can be found in this Court's decisions on the amendment of corporate charters. *See Shields v. Ohio,* 95 U.S. 319, 324-25 (1877) ("The power of alteration and amendment is not without limit. The alterations must be reasonable; they must be made in good faith, and be consistent with the scope and object of the Act of incorporation.").

[14] The States of Alaska, Illinois, Michigan and New York have written into their constitutions provisions protecting

Which particular state common law approach to public employee pension benefits is adopted in a particular jurisdiction is, of course, utterly crucial to a judicial finding of whether legislative change is permissible. Yet this widespread diversity has never deterred this Court from looking to this "law of the place" to determine the existence and extent of a purported pension contract in a Contract Clause challenge to state pension law changes. *See Minneapolis Police Relief Association v. Sundquist,* 104 S. Ct. 1902 (1984) (mem.) (upholding a two percent increase in employee contributions); *Allen v. Bd. of Adm. Publ. Emp.,* 104 S. Ct. 1262 (1984) (mem.) (upholding pension law changes decided below under "reasonable modification" approach); *Lyon v. Flouring,* 396 U.S. 274 (1970) (mem.) (upholding pension law change on "reasonable modification" theory); *Dodge v. Board of Education,* 302 U.S. 74 (1937) (Rejecting a Contract Clause challenge to actual reduction in retiree benefits on a "no contract" theory.).[15]

public employee pension rights. For a discussion of the various common law approaches to public employee pension benefits, *see Pineman v. Oechslin,* 637 F.2d 601, 604-05 (2nd Cir. 1981); *Pineman v. Oechslin,* 488 A.2d 803 (Conn. 1985); Note, "Public Employee Pensions in Times of Fiscal Distress," 90 Harv. L. Rev. 992, 998-1005 (1977); Annot: "Vested Right of Pensioner to Pension," 52 A.L.R.2d 430 (1957) (and Supplement).

[15] There is nothing in *United States Trust Co. v. New Jersey,* 431 U.S. 1 (1977) that remotely suggests that state common law need no longer be examined to determine the existence and terms of a pension contract. That decision reaffirms the "law of the place" tenet and recognizes that amendment or modification of a statutory contract is permissible. 431 U.S. at 19. *See* Schwartz, "Old Wine in Old Bottles: The Rennaissance of the Contract Clause," 1979 S. Ct. Rev. 95, 99. The reason this Court did not have to look to state law in *United States Trust* was that "the settled rule of decisions" in the Supreme Court, Hale, "The Supreme Court and the Contract Clause: III," 57 Harv. L. Rev. 852, 869 (1944), including 100-year old precedent on the enforcibility of bond contracts, 431 U.S. at 24-25, n.22 and n.23, made such an inquiry utterly unnecessary. Moreover, summary dispositions in public employee pension law cases both before

What did the lower courts find when they examined the Maryland "law of the place" incorporated into Petitioners' alleged statutory contract? They found Maryland precedent concluding that public employee pension rights were contractual to the extent that "future benefits vested as they were proratedly earned," *City of Frederick v. Quinn, supra,* 35 Md. App. at 630. But under *Quinn* even earned benefits could be changed:

> The pension plan is not immutable and the government-employer need not keep its provisions precisely intact. As government grows in size and complexity and as more employees draw from the fund, changes must often be made to assure the soundness of the fund and permit its growth commensurate with its prospective needs. The contractual or vested rights of the employee in Maryland are subject to a reserved legislative power to make *reasonable modifications* in the plan, or indeed to modify benefits if there is a simultaneous offsetting new benefit or liberalized qualifying condition. Each case where a changed plan is substituted must be analyzed on its record to determine whether the change was reasonably intended to preserve the integrity of the pension system by enhancing its actuarial soundness, as a reasonable change in promoting a paramount interest of the State without serious detriment to the employee. In short, the employee must have available substantially the program he bargained for and any diminution thereof must be balanced by other benefits or justified by countervailing equities for the public's welfare. *Id.* at 630-31. (Emphasis in original).

See also Baker v. Baltimore County, 487 F. Supp. 461 (D. Md. 1980) *aff'd,* 660 F.2d 488 (4th Cir. 1981) (Applying the reasonable modification test of *Quinn* to changes in a

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and after *United States Trust* make it clear that the "law of the place" and the legislative power to amend pension contracts, are principles that are still very much alive in this area of the law.

contributory municipal pension plan that resulted in an increase in contributions and a capped COLA). The 1979 Maryland General Assembly was aware of its power under *Quinn* to make reasonable modifications, *see* pp. 2-3, *supra;* and the 1984 General Assembly structured its pension reform legislation to accommodate this standard. It gave teachers and employees the option of preserving earned benefits and sought in good faith to substitute member benefits and to preserve the actuarial and fiscal soundness of the retirement systems. *See MSTA v. Hughes, supra,* 594 F. Supp. at 1364, 1368 and 1370. The State submits that the settled law of Maryland[16] permitted the legislative changes challenged by the Petitioners, that two federal courts have applied that law correctly, *see Bishop v. Wood,* 426 U.S. 341, 346 (1976), and that no substantial question is raised by this particular federal determination of State law, *see* Hale, "The Supreme Court and the Contract Clause: III," 57 Harv. L. Rev. 852 (1944), that predetermined the course of this litigation.

[16] Maryland caselaw is no less "settled" because of the possible conflict between *Quinn,* which held a *municipal* pension right enshrined in a charter to be a contract subject to reasonable legislative modification, and *Mazor v. Department of Corrections, supra,* which found a *State* pension to be a gratuity. *See* n.9, *supra.* Both cases accord the legislative body wide latitude in making pension law changes. And although if the issue were before the Court, it would not "assume" the existence of a contract, as Petitioners urge here, and would attempt to resolve the differences in the cases, *see Dodge v. Board of Education,* this certainly is not much of a reason to grant review here.

It is also important to note that other features of the law of Maryland besides *Quinn* militate against easy reliance on a contract of "no change" in pension benefits. Maryland has no impairment of contract clause in its Constitution or a provision preserving public employee pension benefits. Rather, in its Constitution, the State reserves to the people "the exclusive right of regulating the internal government," Article 4, Md. Decl. of Rights; and prevents the Legislature from pledging the credit of the State in aid of individuals, Article III, § 34. In

II.

THE DECISIONS BELOW ARE FULLY CONSISTENT WITH CASES OF THIS COURT AND ARE NOT IN CONFLICT WITH HOLDINGS IN ANY FEDERAL CIRCUIT OR THE HIGHEST COURT OF ANY STATE.

Petitioners strain to find a purported conflict between the decision of the United States Court of Appeals for the Fourth Circuit and cases of this Court as well as those of certain State and federal courts. However, an examination of these decisions reveals no conflict grounded in an interpretation of federal constitutional law. Indeed, as the State has argued above, any conflict in jurisdictions is premised on the "law of the place," not on a variance in the constitutional principles applied to statutory pension contracts.

The employees and teachers assert that the courts below erroneously and singularly concluded that the alleged contract of no change in benefits was "void ab initio" as surrendering an essential element of sovereignty reserved to the states. This is, at best, an overstatement. What the District Court said was that *if* the alleged contract *irrevocably* waived the State's ability to modify the law with respect to *future* pension benefits, it would have constituted a surrender of reserved power. *See MSTA v. Hughes, supra,* 594 F. Supp. at 1362. Because the Maryland caselaw that formed part of Petitioners' contract permitted legislative change, the lower court did not have to decide and, in fact, did not decide a reserved power issue. Nor did the court below give undue deference to the 1984 pension law changes because the purported contract

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addition, in Maryland, State employees do not have "employment contracts" to which a pension benefit could attach and by statute payment of teacher pensions are merely a State grant for aid to education in the counties. *See* Md. Code, Education Article, § 5-201. Finally, Maryland caselaw views as *ultra vires* an attempt by a government body to formally bind itself in perpetuity in the exercise of its governmental powers. *Westminster Water Co. v. Westminster,* 98 Md. 551 (1904).

touched an area of reserved power. Even though it concluded that no substantial contract impairment existed, the District Court nevertheless painstakingly and at length analyzed the justifications for the 1984 law and the problems that led to its enactment to insure that the State's self-interest was not at stake. In short, there was no error in the lower court's application of the reasonable-and-necessary test of *United States Trust* to the facts of this case and in its conclusion that those facts afforded a further ground for upholding the Maryland statute.

Even if the decisions below had rested totally on a finding that Petitioners' alleged contract of "no change" in future pension benefits invaded the State's reserved powers, such a conclusion is not at odds with any decision of this Court. Both *Butler v. Pennsylvania,* 10 How. 400, 417 (1851), and *Newton v. Mahoning County,* 100 U.S. 548 (1879), suggest that in some respects a state's control over the compensation paid its employees cannot be surrendered away by contract. These cases and later decisions of this Court recognize a distinction between compensation contracts for past services and those for future services, as well as those of a short-term and long-term nature. For example, *Butler* (and later *Crenshaw v. United States,* 134 U.S. 99, 106 (1890)) states that:

> The promised compensation for services actually performed and accepted during the continuance of the particular agency may undoubtedly be claimed, both upon principles of compact and of equity; but to insist beyond this on the perpetuation of a public policy either useless or detrimental, and upon a reward for acts neither desired nor performed, would appear to be reconcilable with neither common justice nor common sense.

See also Hall v. Wisconsin, 103 U.S. 5 (1880), holding that a compensation agreement for services actually performed "during a limited period" pursuant to a statutorily-mandated written contract was protected by the Contract

Clause, *id.* at 10; and *Local Div. 589, etc. v. Comm. of Mass.*, 666 F.2d 618, 641 (1st Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982), indicating that:

> [T]he state can override a promise by one of its authorities made several years before that ties the hands of all future legislatures in an area of great importance to the public, concerning serious problems (labor/wage/cost/efficiency negotiations) where few would claim to have found even a provisionally satisfactory answer, let alone a permanent one.

The lower courts here have espoused these very same principles, suggesting only that a permanent contract foreclosing any modification of future rather than earned pension benefits would raise reserved power concerns.

This well-recognized dichotomy between future or past compensation and long and short-term public employee compensation arrangements disposes of Petitioners' ill-founded fears that denial of review here will encourage states to dishonor public employee collective bargaining agreements — agreements that are invariably in effect for only a limited time — and distinguishes all of the collective bargaining cases that are purportedly in conflict with the decision here.[17]

Finally, it should be noted that on every occasion this Court has considered the merits of cases involving changes in government pension plans challenged on a Contract Clause-type of theory, it has upheld the legislative action.

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[17] There are, of course, more compelling reasons to apply the reserved powers doctrine to legislative changes of future pension benefits, rather than mere compensation contracts, because of the far-reaching impact of such pension plans on a State's fiscal health, its bond rating, and the compensation and welfare of its employees. *See AFSCME Councils 6, 14, 65 and 96 v. Sundquist*, 338 N.W.2d 560, 571, n.15 (1983), *appeal dismissed for want of a substantial federal question*, 104 S. Ct. 1902 (1984). However, the question is not presented in this case.

See Minneapolis Police Relief Association v. Sundquist, supra; Allen v. Bd. of Adm. Publ. Emp., supra; Lyon v. Flouring, supra; Dodge v. Board of Education, supra; Pennie v. Reis, 132 U.S. 464 (1898); *United States v. Teller,* 107 U.S. 64 (1883). The State submits that the decisions below are fully consistent with this Court's past treatment of the constitutionality of public employee pension law changes and raise no genuine conflict with any other state or federal case.[18]

[18] Little need be said with respect to an asserted conflict between the Fourth Circuit decision and *Indiana ex rel. Anderson v. Brand,* 303 U.S. 95 (1938). Although decided under the aegis of the Contract Clause, the latter case is simply a forerunner of modern procedural due process cases and First Amendment cases on political firings. It has nothing to do with the issues presented by Petitioners.

Finally, the Petitioners contend that a conflict exists between this and state court cases as to whether the reasonable-and-necessary standard of *United States Trust* can be met by asserting "financial reasons." In doing so, petitioners seek to characterize actuarial soundness, and enhancement of the State's ability to accurately plan fiscal strategy as "financial reasons," thereby stretching the term far beyond the meaning it had in *United States Trust,* where this Court said that "a state cannot refuse to fulfill its financial commitments simply because it would prefer to spend the money for some other purpose." The cases cited by Petitioners do not reveal any conflict worthy of reconciliation by this Court. Two of the cases cited, *Continental Illinois National Bank & Trust Co. v. State of Washington,* 696 F.2d 692 (9th Cir.) *appeal dismissed,* 460 U.S. 1077 (1983); and *Carlstrom v. State of Washington,* 694 P.2d 1 (Wash. 1985), in fact involve a bare desire on the part of the state to spend less money. Two other cases, *Ass'n of Pa. State College v. State System,* 479 A.2d 962 (Pa. 1984); and *Singer v. City of Topeka,* 607 P.2d 467 (Kan. 1980), turn on questions of state law, and do not reach the issue of reasonableness and necessity. *Miles v. Tenn. Consol. Retirement System,* 548 S.W.2d 299 (Tenn. 1976), did not reject the State's asserted purpose of alleviating the funding problems of the pension system, but instead found there had been no factual showing that alleviating the funding problems would protect a vital interest of the state. 548 S.W.2d at 305. Finally, in *Marvel v. Dannemann,* 490 F. Supp. 170 (D. Del. 1980), the court recognized that protection of the fiscal integrity of the fund would serve a substantial and important

III.

NO SUBSTANTIAL FEDERAL QUESTION IS RAISED AS TO WHETHER AS A FACTUAL MATTER PETITIONERS' PENSION CONTRACT WAS IMPAIRED OR WHETHER THE STATE FACTUALLY JUSTIFIED THE NEED FOR CHANGES IN MARYLAND PENSION LAW.

The courts below found no contract impairment both as a legal and a factual matter. Because under Maryland law only "earned" benefits were within the employees and teachers' "contract" and the only non-voluntary option in the 1984 statute (the "bifurcated" option) preserved such benefits, no impairment of a contractual obligation resulted. In part, the District Court characterized this operation of the 1984 law as a prospective rather than retroactive change. Rather than treating the issue in terms of retroactivity, the lower court could have just as easily couched this conclusion as a finding of no contract for future benefits or of no impairment of a contract right, *see In re Enrolled Senate Bill 1269,* 209 N.W.2d 200 (Mich. 1973). Regardless of the characterization, the result is the same, the 1984 statute does not offend the Contract Clause. Moreover, in light of the Maryland cases permitting legislative alteration of benefits, the pervasive State regulation of pensions, including the ongoing study by the Maryland General Assembly of the 1979 pension reform act with an eye toward future changes, and the almost instantaneous troubles the systems experienced,

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public interest, and that it could justify modifications of a pension plan. 490 F. Supp. at 176 and n.6. However, under the facts of that case the court found that the purpose was not to increase the fiscal integrity of the fund, but to provide that public funds would bear less of the cost. In the case at hand, the court found that the actual purpose of the legislation was to enhance actuarial soundness and to allow more accurate fiscal planning. Nothing in the cases cited by Petitioners indicates that these purposes cannot satisfy the test of reasonableness and necessity.

the Petitioners could have no reasonable expectation that the 1979 law would remain unchanged.

Other factors mandated the finding of no substantial impairment. The 1979 statutory "contract" was neither repudiated nor repealed. Only a few of the ten benefits enumerated in the alleged contract were affected by the 1984 legislation. And limiting the COLA and increasing contributions can be "reasonable modifications" to a pension system. *See Baker v. Baltimore County,* 487 F. Supp. 461, 470 (D. Md. 1980), *aff'd,* 660 F.2d 488 (4th Cir. 1981) (Applying Maryland law).

Unique problems are posed by an unlimited cost-of-living adjustment, particularly in Maryland where the cost of the benefit has been totally State-funded. It is a highly volatile benefit that defies predictability of annual costs and responsible planning; it results in lack of growth in funds commensurate with system needs; and it results in too many years when system assets will not exceed liabilities by a comfortable margin.[19] Placing a three percent ceiling on such a benefit contributes to alleviating

[19] Maryland is the only state with an unlimited COLA and the only state advance-funding such a benefit. The effects have been painful and apparent. Since 1975, there have been no major benefit packages for system members, particularly placing members of the new pension system at a comparative disadvantage. Pay increases were becoming increasingly erratic with a resultant adverse impact on the systems. This is so because a pay raise increases the payroll base that funds pensions and annuities; the lack of one results in an "actuarial loss." In the meantime, Maryland has acquired a per capita burden of unfunded pension liabilities that is second in the Nation. It is also noteworthy that critics of the federal employees pension system blame its unlimited COLA for high costs. *See* Committee on Post Office and Civil Services, House of Representatives, "Designing a Retirement System for Federal Workers Covered by Social Security," Comm. Print 98-17, 98 Cong. 2d. Sess. (Dec. 1984) at 85. The latter study notes that private pension plans were indexed to inflation only to about 30 percent. *Id.*

these problems. *MSTA v. Hughes, supra,* 594 F. Supp. at 1368 ("One need not be an actuary to conclude that predictable cost-of-living increases for future retirees stabilizes cash in-flow and out-flow projections, allows for sounder investment strategies, and provides a more predictable basis for actuarial assumptions."). Thus, the lower courts found not only that the 1984 pension law changes were a "reasonable modification," but also reasonable and necessary to serve important state purposes.

Because the Legislature took pains to consider the interests of teachers and employees by developing a "menu" of options for them, it took a future risk for the State by retaining the volatile unlimited COLA for members willing to make a small additional contribution toward retirement costs from their fiscal 1985 pay raise. Nevertheless, this option is a reasonable system modification and no severe burden for employees and teachers. Their contribution rates rose only from five to seven percent. Under Maryland law, State police are presently paying eight percent. Md. Code, Art. 88B, § 56(1)(b). Federal employees pay seven percent. Increased contributions are not deposited in general funds, but go into the annuity fund for the payment of benefits. Moreover, an increase in contributions helps keep that fund in a sound actuarial state.

The actions of the 1984 General Assembly were not only reasonable and enhanced the actuarial and fiscal soundness of the pension systems, but they also resulted in substantial benefits to employees and teachers. First, State employees received a six percent pay raise that automatically translates into higher pension levels in the future. Teachers too received higher pay increases both in 1984 and in future years as a result of the 1984 General Assembly's five-year commitment of $616 million in

increased aid to education. The pay increases will also result in higher pensions for teachers.

Other offsetting benefits are apparent from the 1984 pension reform package. Employees and teachers electing the "bifurcated option" are not obliged to make contributions unless their salary exceeds the Social Security wage base. Old system members will have the future solvency of the system shored up by the General Assembly's decision to use State contributions to the new system to help pay benefits under the old. *See* Chapter 290, Laws of 1984. Finally, capping the COLA will also benefit members of the old system in terms of predictability of costs, financial soundness and future health of the system, and a decline in unfunded accrued liabilities. In fact, under the 1984 statute, the Legislature expressly directed the savings from the measure in Fiscal Year 1985 to be used for reducing unfunded accrued pension liabilities. And this occurred again in FY 1986. Clearly, employees and teachers received sufficient benefits to offset any losses they claim to have incurred.

Finally, Maryland truly believed in 1979 that it had remedied the problems of the retirement systems. It could not have reasonably foreseen early teacher retirements to obtain the unlimited COLA, the astronomical cost-of-living that followed the enactment of the 1979 law, the successful campaign of the unions to discourage transfers into the new systems, or the parade of errors that mushroomed pension costs and unfunded accrued liabilities by billions of dollars. These are unique facts that called upon the Legislature to act. The General Assembly responded in a unique fashion and, in light of the prevailing common law protections afforded public pension benefits in Maryland, addressed this need with a reasonable compromise that took into account, in the greatest way possible, the interests of teachers and employees. The

State submits that review is not necessary by this Court to confirm that result or to consider the many alternate grounds pressed in support of the judgment below.[20]

CONCLUSION

For all of these reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

STEPHEN H. SACHS,
Attorney General of Maryland,
DIANA G. MOTZ,
SUSAN K. GAUVEY,
LINDA H. LAMONE,
CAROL S. SUGAR,
KATHRYN M. ROWE,
ROBERT A. ZARNOCH,
(Counsel of Record),
Assistant Attorneys General,
90 State Circle,
Annapolis, Maryland 21401,
(301) 841-3889,
Attorneys for Respondents.

[20] The State advanced additional grounds below that support the judgment that the 1984 law was constitutional, *viz:* (1) that under *Mazor v. Department of Corrections, supra,* and other relevant "law of the place," the 1979 statute could create no contract; (2) that Petitioners, who were neither induced to employment by the alleged 1979 contract nor declined outside employment solely to remain in the old retirement systems, can point to no legally sufficient consideration to support a statutory contract; (3) that the alleged contract of "no change" in benefits was conditioned on the success of the 1979 pension reform legislation and that the failure of reasonable legislative expectations for such reform justified the 1984 changes; and (4) that employees and teachers were justly compensated for any impairment of their rights.

Supreme Court, U.S.
FILED
APR 17 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1465

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

MARYLAND STATE TEACHERS ASSOCIATION, INC., *et al.*,
Petitioners,

v.

HARRY HUGHES, GOVERNOR OF THE STATE OF MARYLAND, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF

ROBERT H. CHANIN
(Counsel of Record)
JULIA PENNY CLARK
BREDHOFF & KAISER
1000 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 833-9340

WALTER S. LEVIN
WEINBERG & GREEN
100 South Charles Street
Baltimore, Maryland 21201
(301) 332-8705

J. EDWARD DAVIS
MONICA L. NEWMAN
DAVIS & JENKINS
409 Washington Avenue
Towson, Maryland 21204
(301) 494-9000

Attorneys for Petitioners

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1465

MARYLAND STATE TEACHERS ASSOCIATION, INC., *et al.*,
Petitioners,

v.

HARRY HUGHES, GOVERNOR OF THE STATE OF MARYLAND, *et al.*,
Respondents.

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REPLY BRIEF

Respondents assert in their Brief in Opposition that the courts below rejected petitioners' Contract Clause claim fundamentally because of a determination, as a matter of *state* law, that the Maryland legislature was free in 1984 to decrease public employee retirement benefits despite the statutory promise made in 1979 to continue those benefits "without change." Respondents suggest that "no substantial question is raised by this particular federal determination of state law . . . that predetermined the course of this litigation." (Brief in Opposition, at 16).

This Court has held unmistakably, however, that when a federal court is "asked to invalidate a state statute upon the ground that it impairs the obligation of a contract, the existence of the contract and the nature and extent of its obligation become *federal* questions." *Irving Trust Co.* v. *Day*, 314 U.S. 556, 561 (1942) (emphasis added); see *Indiana ex rel. Anderson* v. *Brand*, 303 U.S. 95, 100 (1938) (although involving an appraisal of state statutes, "whether a contract was made, what are its terms and conditions, and whether the State has, by later legislation, impaired its obligation" are ultimately federal questions). See also *United States Trust Co.* v. *New Jersey*, 431 U.S. 1, 17-18 & n.14 (1977). Although, in resolving these federal issues, the court should take into account the State's law of contracts, "finality cannot be accorded to the views of a state court." [1] *Irving Trust Co., supra*, 314 U.S., at 561.

In this case, the State affirmatively and unequivocally promised in 1979 to continue existing retirement benefits "without change." And the district court "assumed, without deciding, that the 1979 Act created a contract between the State and its employees and teachers." (Pet. App. 25a). The precise obligation that was created by that statutory contract, whether the State subsequently breached this obligation, and, if so, whether the breach was permissible are questions of *federal* law.[2] And as we de-

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[1] Respondents suggest that petitioners conceded below that the statutory contract at issue could be altered exclusively as a matter of state law, and in support of this assertion cite a passage from the district court's decision. (Brief in Opposition, at 10). In the passage cited, the district court is referring to an acknowledgment by petitioners that the State may alter its contracts "consistent with the Contract Clause of the Constitution." (Pet. App. 26a).

[2] Cf. *Cleveland Board of Education* v. *Loudermill*, 105 S. Ct. 1487 (1985) (although "property" interests for purposes of applying the Due Process Clause are derived from state law, they are not "defined by, and conditioned on, the legislature's choice of procedures for [their] deprivation; *federal* law determines the procedures that must be satisfied as a prerequisite to deprivation).

veloped in our petition, the courts below decided these questions inconsistently with principles established by this Court and other lower courts.

The decisions of this Court cited by respondents in support of their assertion that state law must be determinative in a case such as this[3] do not stand for that proposition. This Court did not hold in any of those decisions that state law standards regarding modification of public contracts will govern the determination whether or in what circumstances an express legislative commitment *not* to change existing benefits may be renounced or impaired. As a matter of *federal* law, pre-existing state law holding that the legislature has the power to change public contracts must be deemed superseded by a statutory contract promising not to exercise that power and not to make such changes.[4] Impairment of the promises of such a statutory contract—like those of any other contract—may be achieved only in accordance with the conditions imposed by the Contract Clause.[5]

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[3] *Ennis Water Works* v. *Ennis*, 233 U.S. 652 (1914); *United States Trust Co.* v. *New Jersey*, 431 U.S. 1 (1977); *Von Hoffman* v. *City of Quincy*, 4 Wall. 535 (1867); *Minneapolis Police Relief Ass'n* v. *Sundquist*, 104 S. Ct. 1902 (1984) (mem.); *Allen* v. *Bd. of Adm. Publ. Emp.*, 104 S. Ct. 1262 (1984) (mem.); *Lyon* v. *Flouring*, 396 U.S. 274 (1970) (mem.); *Dodge* v. *Board of Educ.*, 302 U.S. 74 (1937).

[4] Indeed, the Maryland authority upon which respondents rely does not speak to whether or in what circumstances an express legislative promise not to change retirement benefits may be overcome by power that the legislature might *otherwise* have retained to modify statutory retirement benefits. See *City of Frederick* v. *Quinn*, 35 Md. App. 626, 371 A.2d 724 (1977).

[5] If, in the name of defining the existence or scope of contract rights, a State were free to substitute its standards for the modification of otherwise clear and binding public contracts for the *federal* standards applicable under the Contract Clause, the Contract Clause would be reduced to a nullity. As indicated in note 4, *supra*, Maryland has not purported to do so, and, if the district court intended to invoke Maryland law to accomplish this result, it erred as a matter of *federal* law.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in our petition for a writ of certiorari, the petition should be granted.

Respectfully submitted,

ROBERT H. CHANIN
(Counsel of Record)
JULIA PENNY CLARK
BREDHOFF & KAISER
1000 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 833-9340

WALTER S. LEVIN
WEINBERG & GREEN
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